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REVIEW OF ALL ASPECTS OF THE SET OF MULTILATERALLY AGREED EQUITABLE PRINCIPLES AND RULES FOR THE CONTROL OF RESTRICTIVE BUSINESS PRACTICES

STRENGTHENING THE IMPLEMENTATION OF THE SET

The role of competition policy in economic reforms in developing and other countries

Revised study by the UNCTAD secretariat

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SUMMARY AND CONCLUSIONS

1. Strengthened competition is a key element in ensuring the success of deregulatory economic reforms being adopted worldwide. For this purpose, market forces need to be supported by rules of the game. Although several developing and other countries have adopted or are preparing competition laws and policies, many countries have yet to do so. The **economic and consumer welfare benefits** of applying a competition policy in the latter countries, need to be better appreciated particularly during the transition before reforms induce self-correcting market forces, in view of the fact that competition promotes efficiency **and the development of the business community so as to build up a "constituency" for a competition policy, it would be useful to have empirical evidence of the economic benefits it brings.**

2. Likewise it would be desirable for competition authorities to both control restrictive business practices (RBPs) by private firms and act as advocates for competition policy in the elaboration of other government policies. While adhering to basic universally valid principles, competition policy should be applied with flexibility in the light of the specific circumstances of individual countries, taking into account **both consumer welfare and** efficiency considerations, and the need to win the confidence of the public and the business community. Priorities should be established bearing in mind inter alia the need to support and supplement economic reforms. **However, the ultimate test of a competition law is whether it is effectively implemented, and how effective the techniques used are for detecting and sanctioning RBPs.** The effective implementation of competition policy would also require the provision of adequate resources.

3. Price liberalization has been a key measure of economic reform in many countries. Competition authorities **might** contribute to this process by advocating further liberalization or by advising that competition problems might arise in certain sectors, as appropriate. They **might** also ensure that firms do not keep prices artificially high, particularly in key sectors. However, care **might** be taken not to restore price controls in another form, **or to have** a disproportionate focus on price abuse supervision. Allegations of predatory pricing should also be treated with caution.

4. Control of mergers and other structural arrangements provides the opportunity for competition authorities to undertake pre-emptive intervention against the anti-competitive effects which may arise from concentrated market structures. Where existing structures are very concentrated, proactive demonopolization measures may also be necessary. But where merger control or demonopolization is considered inadvisable because economic reforms would allow sufficient market entry to increase competition, or because efficiency benefits might be forgone, stricter controls on anti-competitive conduct **may** be necessary. In controlling horizontal practices, it would often be advisable to proscribe horizontal price-fixing and similar practices because of the probability they will have anti-competitive effects, and in order to

facilitate enforcement. But other horizontal practices or joint ventures might be evaluated on a case-by-case basis or be granted block exemptions because of efficiency considerations. Competition authorities **usually** evaluate **most** vertical RBPs on a case-by-case basis, taking into account the existence of dominant positions of market power. A relatively strict approach to vertical restraints may **sometimes** be justified in the market conditions in developing and other countries, but any pro-competitive benefits should be taken into account. **Given the complexities involved in this area, it would be useful to have more analysis by UNCTAD of the competition policy treatment of vertical restraints, abuses of dominant position, as well as related questions of the exercise of intellectual property rights and the licensing of intellectual property rights and of know-how, and of the interface between competition, technological innovation and efficiency.**

5. **In natural monopoly industries, any liberalization of regulatory barriers to entry might be balanced with appropriate safeguards.** Competition laws have been **applied for this purpose in some countries, often** supplemented by various forms of industry regulation. For developing and other countries, the choice of regulatory mechanisms should depend on their market conditions, level of development and administrative capacity and institutions. Some general principles might be followed; the Ad Hoc Working Group on Comparative Experiences with Privatization recommended inter alia that a clear regulatory framework and procedures should be established before privatizing a public utility and that market structures allowing for the maximum possible competition should be created. Controlling natural monopolies in an optimum manner is difficult, and may be facilitated for developing and other countries by splitting up monopolies (where compatible with efficiency) and by different contractual arrangements. Technical cooperation from countries with experience in this area would be useful.

6. In accordance with the recommendations of the Ad Hoc Working Group on Comparative Experiences with Privatization, privatization in contestable industries should be supplemented with measures to ensure that public monopolies are not merely transformed into private monopolies, which would reduce the efficiency-increasing potential of privatization. But demonopolization measures may be difficult to undertake at the time of privatization because of adverse reactions from potential acquirers. Such problems might be reduced if demonopolization was implemented prior to privatization as far as possible. This would also better prepare public enterprises to compete effectively. Competition authorities might advise on how to privatize in a manner enhancing competition and should also exercise RBP controls upon privatized firms, particularly if they continue to retain dominant market positions.

7. Foreign direct investment into developing and other countries has usually had extensive effects in either increasing or reducing competition, as well as in increasing efficiency, in those product markets where it concentrates. **Since transnational corporations, (TNCs') greater efficiency, size or global orientation may often enable them to acquire**

dominant positions, competition authorities would need to make efforts to prevent them from abusing their dominance, but the principle of national treatment should be adhered to, and efficiency considerations and intra-corporate links should be taken into account. The application of such **RBP** controls would not usually act as a deterrent to foreign investors, particularly if **they** follow universal competition principles, and may provide them with stability and security. However, it would sometimes be more effective to reduce market-entry barriers to foreign investment, which should increase flows of foreign investment and encourage the growing trend towards diversification in sources of foreign investment other than large TNCs. Investment incentives, subsidies or special protection for foreign investors should **also** be controlled, in consultation with competition authorities.

8. Imports are critical to ensuring competition in the markets of developing and other countries, although they have some limitations in this respect. Competition authorities should estimate the real effects of actual or potential imports and control RBPs reducing their beneficial effects, including by paying attention to abusive exercises of intellectual property rights, RBPs by foreign exporters, and exclusionary distribution structures. It may sometimes be necessary to have recourse to extraterritorial jurisdiction **including in cases of international cartels and other RBPs having effects in more than one country** but for this purpose, competition authorities in developing and other countries would need more information on the substantive and procedural issues involved, as well as reinforced consultations and cooperation with other countries. Competition authorities might also advocate trade liberalization where appropriate, although such advocacy may be ineffective unless they can induce confidence in their ability to control RBPs by foreign exporters and unless a liberal trade regime is also maintained by trading partners.

9. Trade and foreign investment liberalization, while increasing international competition in many sectors, may **enhance the incentive for firms to resort to RBPs to maintain their market positions, and may also** reinforce oligopolistic global market power in **some sectors**, including some high technology sectors. This may be difficult for individual competition authorities to control. Strengthened cooperation among competition authorities would assist in ensuring the accountability of such oligopolistic global firms, in minimizing tensions among countries relating to competition and trade issues, in providing market access opportunities to firms from all countries and in protecting global economic efficiency and consumer welfare. There is also scope for using competition concepts and philosophies for mitigating the protectionist bias of trading regimes; this would necessitate multilateral action to follow up on the Uruguay Round Agreements. **As a prelude to multilateral action in this area, efforts might be undertaken to identify or to strengthen "common ground" among Governments, including in-depth analyses of differences in the scope of competition laws in individual sectors, and of the effectiveness of enforcement of competition laws, including enforcement in cases of RBPs having effects in more than one country.**

10. In the light of the above, actions by States might include:

(a) The adoption, improvement and effective implementation of competition policies by developing and other countries, integrated into the framework of their economic reforms;

(b) Taking into account the effects of economic reforms such as price liberalization, privatization, demonopolization and liberalization of foreign investment and trade in the application of competition policy **at the national, regional and international levels, and the identification and adoption of appropriate measures to help those countries that might be hampered by RBPs**;

(c) Establishing appropriate **techniques and procedures for detecting and sanctioning RBPs, including international cartels and other RBPs having effects in more than one country, for** control**ling** RBPs or **abusive** pricing by natural monopolies and **for** ensur**ing**, where possible, that privatization does not result in the replacing of public monopolies by private monopolies;

(d) Providing technical cooperation to assist such endeavours, within available resources and tailored to the requirements of individual countries or groups of countries, **and the strengthening of information exchange, consultations and cooperation in enforcement at the bilateral, regional and multilateral levels**;

(e) Full implementation of all provisions of the Set of Principles and Rules, in order to ensure its effective application;

(f) Work by the UNCTAD Intergovernmental Group of Experts comprising: (i) an analysis of **how to improve the delivery of, and results obtained from, technical cooperation in this area; (ii) identifying "common ground" in the approaches followed on different competition questions by Governments; (iii) shedding light and encouraging exchanges of views in areas where the "identification of common ground" is more difficult, such as the role of competition policy in the strengthening and improvement of the economies of developing and other countries and, in particular, the development of the business community; taking into account economic globalization and liberalization of the economies of developing and other countries, the identification and adoption of appropriate measures to help those countries that might be hampered by RBPs; the interface between competition, technological innovation and efficiency; the competition policy treatment of vertical restraints and abuses of dominant position, the competition policy treatment of the exercise of intellectual property rights and of licences of intellectual property rights**

and know-how; (iv) an analysis of differences in the scope of competition laws in individual sectors, in the light of the process of economic globalization and liberalization; and (v) an analysis of the effectiveness of enforcement of competition laws, including enforcement in cases of RBPs having effects in more than one country;

(g) In the light of such work, consultations in the context of the UNCTAD Intergovernmental Group of Experts on: how the Set of Principles and Rules might be better implemented; the competition policy implications at the national, regional and international levels of globalization and liberalization; techniques and procedures for detecting and sanctioning collusive tendering, including international cartels and other anti-competitive practices; and the strengthening and encouraging information exchange, consultations and cooperation mechanisms in enforcement at the bilateral, regional and multilateral levels.

INTRODUCTION

11. The present study constitutes a revised version of a study 1/ which was **originally** prepared in accordance with the agreed conclusions adopted by the Intergovernmental Group of Experts on Restrictive Business Practices at its eleventh session; it is based on an outline approved by the Group. 2/ **The original study had been revised at the request of the Group of Experts** at its twelfth session. 3/ **At its thirteenth session,** the Group of Experts concluded that the study (TD/B/RBP/96/**Rev.1**) should be **further** revised by the secretariat, taking into account comments made during the **thirteenth** session and those received from Member States before 31 January **1995**. 4/ The present revised version has been prepared in the light of these comments, as well as relevant up-to-date data. It also reflects a recent decision of the Trade and Development Board, 5/ as well as **the agreed conclusions of the Group of Experts at its fourteenth session, 6/ and** the conclusions and recommendations adopted by the UNCTAD Ad Hoc Working Group on Comparative Experiences with Privatization. 7/ **To facilitate identification of changes made to the previous text, additions to the text appear in large characters and in bold type.**

12. The study examines the relevance and potential contribution of competition policy to the process of economic reform taking place in developing and other countries, in terms of both control of restrictive businesses (RBPs) and competition advocacy by competition authorities. Particular reference is made to policies relating to prices, demonopolization and privatization and foreign investment and trade. Chapter I brings out how economic reform and liberalization may be supported and supplemented by competition policy and suggests some approaches and priorities that might be adopted by competition authorities for this purpose. Chapter II discusses the role of competition authorities in relation to price liberalization and how they can help Governments to ensure that its benefits for economic efficiency are not lost through market concentration, horizontal RBPs or vertical RBPs by firms in a dominant position of market power. Chapter III highlights the special problems involved in the regulation of or the behaviour of natural monopolies and the approaches which developing and other countries might adopt in this area. Chapter IV discusses how to ensure that privatization does not result merely in the transformation of public to private monopolies, and the appropriate timing for demonopolization measures. Chapter V examines the relationships among competition and liberalization of direct foreign investment and import trade and discusses the specificities involved in the application of competition policy to foreign investors and to overseas firms. The need for policy coordination in this area, at both the national and the international levels, is emphasized.

13. Throughout the study, references are made to an earlier study by the UNCTAD secretariat entitled "Concentration of market power in the markets of developing countries through mergers, joint ventures, and other acquisitions of control, and its effects on international markets, in particular the markets of developing countries" (TD/B/RBP/81/Rev.2), hereinafter called the "Concentration study".

Chapter I

COMPETITION AND LIBERALIZATION IN COUNTRIES UNDERTAKING ECONOMIC REFORMS AND THE ROLE OF COMPETITION AUTHORITIES

A. The role of competition policy in economic reforms

14. Fundamental economic reforms have been adopted worldwide over the last 15 years or so, many of them motivated by a growing recognition of the role of the market and of the private sector in the efficient functioning of economies at all stages of development. In developed countries, various regulations affecting prices, market entry or exit and monopolies, as well as the ambit of RBP laws, have been liberalized or reformed, and large privatization programmes have been implemented in a number of them. In many developing countries, market-oriented reforms have been pursued, including structural or sectoral reforms of varying degrees of ambition, notably in areas of trade policy, investment policy, privatization and, where applicable, deregulation (including the reduction of subsidies, administrative allocation of key production inputs, price controls, establishment and capacity licensing requirements, exclusivity arrangements and exit barriers). In former centrally planned economies, far-reaching institutional changes have been accompanied by moves to market-based economic systems integrated more closely into the world economy. Such reforms in a large number of countries have by no means been finalized; although major efforts have been made, an immense task still lies ahead.

15. A common aspiration underlying these reform efforts has been that the reduction of governments' direct involvement or intervention in economic activity would, by providing enterprises with more freedom and stronger incentives, stimulate entrepreneurial activity, business efficiency, productive investment and economic growth, as well as enhance consumer welfare through improved quantity and quality of goods at prices which are lower (at least in the long run). Throughout the economy, therefore, productive resources would be allocated in an efficient and flexible manner through the decentralized decisions of market operators rather than by government direction or through rent-seeking activity, and economic growth could improve. However, such aspirations are likely to be fully realized only if enterprises act under the spur of competition, so that consumer dissatisfaction is able to provide a market sanction for poor performance. Thus, the strengthening of competition (in conjunction with measures to stimulate consumer awareness) is a key element in ensuring the success of economic reforms.

16. Largely for such reasons, several developing countries 8/ and countries of Central and Eastern Europe, 9/ as well as China, have adopted competition laws or reformed existing laws in recent years, while several more countries are in the process of doing so. Yet many other countries which are undertaking economic reforms have neither competition laws nor even explicit competition policies. While this may be due, to some extent, to lack of information by policy-makers, there may also be a reluctance to adopt competition laws because of the feeling that competition controls would restrict business activity and market forces and thus go against the trend towards economic liberalization which would suffice by itself to ensure a competitive market. There may also be concerns about weakening the market

position of domestic enterprises at a time when they are faced with difficult challenges or about deterring foreign investors, particularly as national markets may realistically be able to support only a small number of producers at economic scale; atomistic competition has been seen as leading to excess capacity and waste of resources. There are related concerns about the difficulties and costs to enterprises of complying with reporting or investigatory requirements, which would give rise to complaints about "red tape"; there is often strong opposition by the business community to the adoption of a competition law because of fears about creating a new layer of regulation, giving rise to opportunities for bureaucratic and political interference and favouritism. 10/ There may be doubts about the ability of competition authorities to detect or to prove that RBPs have been committed, given the difficulties involved in a developing country environment. Finally, the creation of a new regulatory body to implement competition policy would involve costs for Governments at a time of budgetary stringency. **Even where Governments do succeed in adopting a competition law, the opposition to it from the business community may lead to a weakening of its provisions before it can be enacted; this happened in Jamaica, for example, leading inter alia to the removal of provisions for the control of mergers and interlocking directorates from the proposed competition law.** 11/ Some answers to such concerns are suggested below, as well as some approaches to competition policy implementation that may help to strengthen the relevance of competition policy in the context of reform in developing and other countries.

17. Although liberalization of regulatory barriers does increase (and, in many cases, already has increased) opportunities for competition, such barriers are **prevalent** in many developing and other countries, and are likely to play a role for some time to come, while liberalization policies alone will not suffice to overcome other disincentives to market entry. As was brought out in the Concentration study, 12/ domestic markets in most developing countries are usually highly concentrated, because the level of demand in these markets can sustain relatively few firms producing on a minimum economic scale. Other disincentives include the limited availability of entrepreneurs and of production inputs, inefficient distribution and communications systems and poor information flows. This is also **often** the case in several countries of Central and Eastern Europe, where vertical integration **or product market segmentation may be** particularly high. The adoption and implementation of competition safeguards are particularly important in countries which are in the process of building up market mechanisms and institutions, because of the risks of missing the opportunities that liberalization provides to increase competition. It usually happens, for example, that countries undertaking stabilization and structural adjustment programmes implement reforms in phases. For example, they may implement some fiscal and monetary reforms (such as price decontrol, tariff reform and devaluation) rapidly, whereas institutional ingredients of their programmes, particularly aspects of domestic deregulation, public enterprise reform and privatization, may not be in place for several years, **given the wide variety of regulations in different areas which may restrict competition.** In such circumstances, there would be a lag before reforms would generate sufficient competition to create self-correcting market forces.

18. In the interim, incumbent firms may take advantage of deregulation to engage in RBPs previously prevented by government intervention and to block market entry, thereby hampering the development of the private sector and the expansion of the base of entrepreneurship which is essential to the success of reform efforts in many countries. Not only may this happen in sectors where incumbent firms already have a market-dominating position, but there may be expansion by such firms into other newly deregulated industries. The problem is not merely a transitional one; once firms have been allowed to entrench their positions through anticompetitive conduct or structures, it may be difficult to take corrective action without damaging the economy and business confidence in the process. Indeed, it may well be partly because of the failure to provide adequate competition safeguards that policy reforms in some countries have not so far been as fruitful as hoped for.

19. It is sometimes argued that the development process is best served, at least initially, by efficient monopolies and that competition can be introduced at a later stage through deregulation, i.e. that, particularly in the circumstances of countries with small markets, a trade-off may initially be necessary between economies of scale and economic growth, on the one hand, and consumer welfare, on the other. However, such arguments place too little weight on the objective of consumer welfare and on the extent to which this objective converges, rather than conflicts, with promoting business efficiency. Exposure to competition is **both** the most effective way of promoting the ability of firms and industries to perform effectively on national and international markets, (**including by** lower**ing the** costs of intermediate inputs for final producers**) and of ensuring that enterprises pass on to the consumer at least some of the benefits obtained from efficiency improvements**. It may also be noted that the importance of economies of scale varies greatly in different industries. Most efficiency gains are achieved at a relatively small size of operations and there is no evidence of a systematic correlation between firm size and efficiency. Large conglomerates have often been associated with inefficiency. Moreover, in countries with shortages of capital or entrepreneurs, it is not guaranteed that new market entry will eventually palliate the effects of failing to create a competitive industry in the first place; even if it does, this may be at the cost of over-capacity in industrial plant and higher prices. It is true that there is some evidence indicating that price-cost ratios, taken as an index of gross return on capital, are positively correlated with market shares of individual firms and industrial sector concentration ratios in several developing countries, but it is not clear whether this is due to relative efficiency or **to** lack of competition. 13/ In any event, as discussed below, competition policy can be implemented to take efficiency considerations into account (such as in merger control), **although it should try to ensure that a fair share of the benefits from efficiency gains are passed on to the consumer.**

20. Economic reform, while generally requiring a reduction in direct intervention by the State in economic activity, would also necessitate a more effective presence in providing an enabling framework for enterprises to engage in such activity. Experience has shown that the attainment and maintenance of competitive markets cannot be done through complete

laissez-faire, but requires "rules of the game". The more one removes direct government controls over the economy, the more one must work to ensure the maintenance of competition in their place. Thus, even the most advanced countries, which have long adhered to liberal economic policies and which have large markets where entry is relatively easy, have found it necessary to maintain active competition policies and to keep adapting them to new challenges. Controls upon RBPs by some firms preserve the overall freedom of all enterprises to conduct their businesses in a legitimate manner, allow freedom of market access to aspiring entrepreneurs and also protect consumer welfare, thus providing a healthy and supportive climate for economic activity.

21. Moreover, competition policy in its broad sense is concerned not only with private but also with regulatory restraints upon market forces. In this respect, it coincides with economic liberalization policies. In addition, however, it enables liberalization policies to be designed and implemented in a manner which takes into account the interaction between governmental and private restrictions. In all countries with competition laws, the competition authorities control the RBPs of enterprises. In some of these countries, these authorities also advocate measures to prevent distortions to competition and facilitate market entry in formulating and implementing other government policies, thus helping to create the basic pre-conditions for effective competition. Such an advocacy function is particularly important in countries where a competition philosophy may not be completely understood or accepted. In the absence of a well-articulated competition doctrine, there is a heightened risk that individual firms which are, in principle, favourable to liberalization, will successfully lobby against specific liberalization measures which adversely affect their interests.

22. This does not mean that competition policy should be formulated and implemented in a doctrinaire and inflexible manner, or that it necessitates a commitment to any particular competition theory. In several countries which have had long experience in this field, action against RBPs is undertaken on the basis of thorough economic analyses taking into account behavioural factors rather than just market share data, including possibilities for product substitution and market entry, and the impact of technological change. Efficiency gains may be taken into account, as well as competition from imported goods, and (in some countries) the existence of an international market and the competitiveness of national firms vis-à-vis foreign firms in domestic and overseas markets. Moreover, in several competition laws, exemptions from RBP controls (or relatively lenient controls) may be provided for some types of practices or joint ventures, or for some industrial sectors (particularly declining or high-technology sectors), because of considerations of efficiency, industrial policy or competitiveness. Competition would usually be the main criterion, but other public interest criteria would not be lost sight of. In many countries with competition laws, competition principles are also sometimes not fully adhered to in some policies relating to such areas as trade, industrial promotion policy, public procurement, or subsidies. The arguments made in favour of such policies in relation to high-technology industries, in particular, have some similarities with the "infant industry" arguments long made by developing countries.

23. In the context of developing or other countries undergoing economic reform, proper economic analysis and flexibility in applying competition policy may be even more necessary so as not to impede efficiency, growth or development goals. This is recognized in the Set of Principles and Rules, which provides for preferential or differential treatment for developing countries in this area, and for account to be taken, in the control of RBPs, of the development, financial and trade needs of developing countries, for the purpose especially of promoting the establishment or development of domestic industries and the economic development of other sectors (para. C.7). Competition policy should be based upon the universally valid basic principles of competition, but it has to take into account the circumstances of individual countries, and cannot operate in a vacuum divorced from the pressing realities of countries undergoing economic adjustment; otherwise, it might be brushed aside as irrelevant. Pragmatic compromises may be justified in the short term, as long as the momentum of progressive movement towards competitive markets is maintained. However, great care would be needed in the granting of industrial policy exemptions from competition policy, given the difficulties of "picking winners" and determining which industries or firms should benefit from such measures, and the risks that they will be captured and distorted by individual firms to their own benefit. In formulating and implementing competition policy, it would be better explicitly to factor in efficiency considerations, using objective and transparent criteria so as to avoid misuse of efficiency arguments. Claims about efficiency gains should be critically assessed; it should be explored whether it would be possible to improve efficiency through alternatives posing less danger to competition, and consumers should obtain a fair share of any cost reductions or other gains obtained from improvements in efficiency. The rationale of any exemptions from competition policy that may be granted should be regularly re-assessed. **To assist developing and other countries to make appropriate decisions in this connection, it would be useful to have more data on the interface between competition, technological innovation and efficiency.**

24. The universal acceptance of the principle of free competition and of the mechanisms necessary to safeguard it is the best means of minimizing demands for special protection or for exemptions from competition law. A high priority should therefore be given to pedagogical efforts aimed at creating a "constituency" for competition **policy** by educating **government officials,** enterprises, consumer associations and the public regarding the benefits of free competition and the adverse effects of RBPs. This would be particularly necessary in enforcing a new competition law in countries undertaking economic reforms, because the law would make illegal practices that had hitherto been accepted or even promoted by the government. **To help educate all concerned about the role of competition policy, it would be useful to have empirical evidence of its role in strengthening and improving economies and in the development of the business community.**

25. **However, the ultimate test of a competition law is whether it is effectively implemented, and how effective are the techniques used for detecting and sanctioning RBPs.** The effective implementation

of competition law **would also** depend to a large degree upon whether the public in general and the business community in particular has confidence in the regulatory system and perceives it as a facilitator of the competitive process rather than as a hindrance to efficient business operations. Generating such credibility is particularly important in the early years of developing a competition system and would be assisted by the use of intelligible standards and rules and fair, speedy and efficient procedures, respect for the confidentiality of sensitive business information, impartiality and independence from political directives in applying the law, authority within the government administration and the ability to impose significant penalties and remedies, where appropriate. As the control of RBPs involves making subjective and discretionary judgements, particularly where rule of reason analysis is undertaken, the uncertainty which may thereby be created for business should be reduced as far as possible by issuing guidelines on enforcement policy. Appropriate pedagogical efforts, both within the Government and vis-à-vis the public and enterprises, may also be a means of demonstrating that a free market is not a free good and that, even in conditions of financial stringency, Governments should provide adequate resources for this task (moreover, substantial savings may accrue to the Government from controls on RBPs affecting public procurement). Technical cooperation in this domain from the international community, tailor-made for the needs of recipient countries, would also be useful in training staff in the requisite skills.

26. To help minimize resource requirements, competition authorities should pay more attention to the likely effectiveness and to the quality rather than the quantity of their interventions. The choice of priorities will vary in accordance with the circumstances of each country, **the nature of complaints received from consumers or businesses,** the resources available and the exact functions and powers of the competition authority. Intervention might be most **fruitful** in relation to the areas of prices, privatization, import trade and foreign investment, as discussed in the following chapters, with specific sectors being chosen on the basis of the scope for consistency, feedback and synergy between competition policy and other policies. Thus, for example, competition authorities might advocate the liberalization of government policies reducing the effect of RBP control measures, while enforcement efforts might also focus on economic sectors which have been deregulated, but where effective competition has not yet arisen; particular emphasis could be placed in this connection on enforcement against RBPs blocking market entry, such as horizontal collusion and exclusionary practices of dominant firms. But the choice of priorities in enforcement activity would necessarily depend upon which RBPs are particularly prevalent or harmful in the context of individual developing and other countries; these will often not be the same as those in developed countries. 14/ Priorities might also be focused on those RBPs which are easy to detect or evaluate; thus, for a new RBP control authority, practices subject to outright prohibitions may be easier to deal with than practices requiring complex economic analyses. In addition, a new competition authority could choose its first cases with an eye towards targeting business conduct that constitutes clear and easily understood violations of the law and obviously harms consumers and competition, so as to win over public opinion; again, examples of such conduct would include horizontal price-fixing and exclusionary vertical practices by dominant firms.

B. Experiences of some countries

27. The experiences of the Republic of Korea and Poland provide examples of how competition policy may be integrated into economic reform and liberalization policies and how competition authorities may undertake active competition advocacy and RBP control functions. In the Republic of Korea, the "Sixth Five-Year Economic and Social Development Plan", adopted in 1986, aimed at promoting competition based on free market principles through policies of deregulation, enforcement of the Antimonopoly and Fair Trade Law of 1981 and liberalization of imports and of financial services. 15/ There has been extensive liberalization of systems of price control, business licensing, industry regulation and support, State ownership of enterprises and restrictions upon foreign investment and imports. The competition law requires other government authorities to consult with the Minister of the Economic Planning Board when they wish to introduce, amend, or enact any legislation or order that might restrain competition. The Fair Trade Commission has actively exerted efforts to prevent the introduction of new restrictive regulations by reviewing legislation before its enactment, made efforts to eliminate existing anticompetitive regulations, and, with respect to markets controlled by dominant firms, advocated the elimination of entry barriers and the introduction of foreign competition; **it has also striven to educate government officials, entrepreneurs and consumers about competition issues.** 16/

28. As the economy is characterized by a high concentration of market power in large conglomerates known as "*jaebol*", competition enforcement has given priority to controlling market structure and RBPs by the *jaebol*, while taking account of the high dependence of the economy upon them. Thus, the Fair Trade Law proscribes "business integrations" likely substantially to restrict competition, although exemptions are provided where the aim is to rationalize or to strengthen the international competitiveness of an industry. A special law protects subcontractors from RBPs by main contractors. Priority has also been given to controlling collusive activities of firms and RBPs by trade associations. 17/ **In the area of vertical restraints, there has been a gradual shift from per se prohibitions to rule of reason evaluations.** 18/

29. In Poland, the Economic Transformation Programme in effect since January 1990 is a standard stabilization programme involving price liberalization, cuts in subsidies, reductions in government expenditure, privatization, devaluation and trade liberalization. As it was being implemented in a formerly centrally planned and State-dominated economy, however, its scope was vast; moreover, its components were speedily and simultaneously implemented, applying a "big bang" rather than a gradualist strategy for the transition towards a market economy. The economic reforms created new opportunities for privately owned small and medium-sized enterprises (SMEs), which grew fast, but large public enterprises (PEs) experienced great difficulties. Overall, there was a sharp initial drop in industrial output and economic growth, accompanied by hyperinflation. However, the overall economic situation has improved since mid-1992; and PEs have now substantially improved their performance. 19/ It was in this climate that the Law on Counteracting Monopolistic Practices of 1990 was

adopted **(the law has since been amended)**. In addition, the Government Programme on Competition Development 1991-1993 emphasized the importance of competition law enforcement, trade liberalization and privatization and required ministries and other government agencies to prepare and enforce their own programmes of competition development.

30. The Antimonopoly Office has issued numerous opinions in response to proposals for enactment of legislation submitted by ministries and agencies 20/ and participated in work on establishing competitive market conditions. Emphasis has also been placed on control of abuse by firms holding dominant or monopolistic positions, as well as of cartels and market allocation. **The Office has attached** particular priority to counteracting excessive market concentration, **by expressing opposition to protection of local producers and to the privatization of dominant firms without their being split up, as well as through** control of mergers and other structural arrangements. **However,** the Office has been cautious about putting into effect a broad, radical demonopolization policy because of the great difficulty of finding the proper balance between a more competitive structure and possible loss of economies of scale and scope, **although** it has acted in several cases. In line with the Government's industrial policy aims of protecting Poland's best companies and certain small companies, the Office accepts some exemptions from competition law requirements, but only if they are related to restructuring efforts and are for a limited and clearly defined period. 21/ **However, the Office has experienced difficulties in its activities from the tendency of other government bodies to protect and promote the interests of producers in the sectors which fall within their responsibility, such as in agriculture or telecommunications. 22/ In an effort to promote transparency, the Office has issued numerous guidelines and communiqués explaining its activities; it is also strengthening exchanges of market information with consumer bodies. 23/**

Chapter II

COMPETITION AND PRICES

A. The advantages and difficulties of price liberalization and the role of competition authorities

31. Accurate price signals facilitate efficient and flexible resource allocation at both macro- and microeconomic levels. The advantages of accurate pricing are especially great in countries where resources are particularly scarce, since their need for efficient resource allocation is greater, and since the administration of price controls necessitates an expensive bureaucracy. Yet precisely because of their limited resources, developing and other countries often aimed in the past at minimizing (through subsidies) the prices of products which met the basic needs of low-income sections of the population, or which were production inputs for sectors that Governments were trying to promote. The high price distortion in these countries adversely affected competition and efficiency, discouraged investment, decapitalized enterprises and led to shortages and poor quality of goods. In Brazil, for instance, by institutionalizing the periodicity and method of price setting, controls not only precluded price competition, but induced explicit and tacit collusion among firms, both when price controls were in effect and after they were eliminated. 24/

32. A central element in many economic reform programmes has therefore been price liberalization measures. These have ranged from immediate abolition to more gradual dismantling of price controls in respect of consumer products, often linked with the reduction of State subsidies and import tariff rates and the liberalization of prices for labour, energy, land, capital and foreign exchange (the latter usually involving devaluation or floating of the local currency). **Although** liberalization has contributed to decreases in inflation rates in **some** countries over the medium term, such measures have resulted in price rises and inflationary pressures in **other** countries adopting them, although the scale and speed of the price rises have varied in accordance with the country and product concerned. However, it was hoped that the stimulus provided to new production or market entry from the prospect of greater profit would eventually serve to stabilize or even to reduce prices, and to eliminate excess demand. Such hopes have been realized in some countries. In India, for example, where price and distribution controls had insulated producers from competition and from the need for modernization and cost reductions, beneficial results were obtained from price liberalization in such sectors as cement. 25/ In Russia, price liberalization has led to reductions in subsidies, better equilibrium between demand and supply, a wider range of available products, and increased commercial stocks. 26/ However, in many countries, while the speed of adjustment in asset markets after liberalization has usually been swift, the adjustments in commodity and labour markets, let alone the production response that follows from new investment, have been much slower. 27/

33. The issue is therefore how to ensure that the reconstruction of the institutional micro-structure and development of new norms do not lag behind liberalization and decontrol. In this connection, competition authorities in developing and other countries could play a key role in ensuring that price

liberalization does indeed fulfil its potential in encouraging economic efficiency and in bringing greater competition to play in this process. They might advocate the beneficial effects of liberalization in general, and yet provide inputs for the taking of political decisions as to whether the time is ripe for liberalizing a specific sector, by identifying sectors where market imperfections are likely to lead to significant and non-transitory competition problems. The enforcement efforts of competition authorities might also be focused and timed to mitigate any high inflation immediately following price liberalization, particularly in key sectors. Thus, for example, any economic sector directly or indirectly catering for the basic needs of consumers, particularly the poorest among them, or which has a pervasive impact upon efficiency throughout the economy, might receive special attention. In Poland, for instance, the Antimonopoly Office takes into account price increases in deciding which sectors to examine; a rapid increase in sugar retail prices led to an analysis of prices in this market, together with investigations of the sugar industry, and a cartel was found to exist. 28/ The new competition law of Brazil proscribes inter alia the following practices if there is no "just cause": imposing "excessive prices" (those not justified by increases in supplies or increases in quality); interrupting or reducing the scale of production; or partially or totally stopping the activities of the business. 29/

34. While efforts by competition authorities against price rises may be justified in the short term, particularly in the circumstances of economies in transition to a market economy, they may not necessarily be appropriate as a long-term strategy. Governments, which have greatly reduced their direct measures to keep prices down, would naturally object to efforts by enterprises to keep prices higher than they should be in a fully competitive market. But it should not be overlooked that liberalization necessarily entails some sacrifices and risks and it is legitimate for producers to seek to recoup their increased costs through price rises; unless they are given the freedom to do so, the supply situation will not improve. Competition policy aims at flexible prices which reflect the demand/supply situation, rather than at low inflation or low prices per se; such price flexibility should, by leading to greater efficiency, have a restraining effect on overall price levels in the long term. It may also be noted that price abuse supervision should not lead to the neglect of control of other RBPs; in the rapidly changing environment of countries undergoing economic reform, enterprises may find it difficult to coordinate specific pricing strategies, and may prefer to collude in the form of market sharing arrangements. Competition authorities should also not make the opposite mistake of applying too stringent a standard in evaluating whether a price is too low because of predatory intent; in the wake of price liberalization, efforts by efficient firms to maintain competitive prices could be misrepresented by competitors as constituting predatory pricing.

35. Some criteria which might be taken into account as appropriate by competition authorities in this area are enunciated, for example, in Sri Lanka's competition law. This provides for the Fair Trading Commission, in the exercise of its functions, to have regard inter alia for the protection of consumer interests, the provision of necessary incentives to producers, the necessity for ensuring reasonable rates of return on production capital, the allocation of resources among different sectors, the control of inflation and other objectives of economic and social policy. 30/ The Commission now only

only controls prices of a few food and pharmaceutical products. However, it has the power under its Industrial Promotion Act to review the prices of any article after holding an inquiry and to determine whether the price is unreasonable, in which case it may recommend import tariff adjustments to encourage competition from imports; **one recommendation has been made so far**. An investigation of pricing by a firm having a monopoly in the market for glass bottles found that price rises were due to cost increases; however, an undertaking was obtained in respect of quality control of the bottles. 31/

B. Market concentration and prices

36. The subject of market concentration has been dealt with in depth in the Concentration study, and will only be touched upon briefly here. As noted in that study, economic liberalization is encouraging industrial restructuring in many countries, leading to more mergers and joint ventures, and strengthening market concentration in many cases (while decreasing concentration in other cases). Competition authorities are still likely to need to deal with far fewer mergers than horizontal or vertical RBPs. Given the complexities of analysing the competition and efficiency effects of mergers, and the fact that they may not appear to have a direct and immediate impact upon prices, competition authorities in some countries may tend to place less emphasis on merger control. But the importance of mergers and other arrangements affecting market structure should be looked at in qualitative rather than in quantitative terms, and in a long-term perspective; since they may result in lasting changes to competition, particularly in the small and concentrated markets of many developing countries, it would often be better to undertake pre-emptive merger controls than later to attempt to control market conduct or market performance which may only be a symptom of anticompetitive structures, **and which may often be difficult to detect**. In countries with very concentrated market structures (such as some countries in transition towards a market economy), merger control may need to be supplemented by proactive "demonopolization" measures to reduce existing market concentration. In the Russian Federation, for example, a State programme entitled "demonopolization of the economy of the Russian Federation" is being implemented to reduce industrial concentration and create favourable conditions for competition; it is pursued in parallel with privatization of PEs, and is supplemented by sectoral and regional programmes for the demonopolization of commodity markets. 32/

37. But a case-by-case analysis is necessary, and where larger firm size or higher market concentration would not equate with significantly greater market power on a lasting basis, **where liberalization of regulatory entry barriers should reduce market power**, or where restructuring is desirable for efficiency reasons, it would be preferable not to intervene. In practice, it may be difficult for a competition authority in a developing or other country to apply **rigid** quantitative criteria **relating to increases in market shares or in prices** in assessing whether market power would be enhanced, since there may already be high **prices and** inflation and highly concentrated market structures, and since companies wishing to merge may be trying to anticipate **or react to** potential changes in market structure

arising from economic reforms. 33/ Inevitably, merger control in such circumstances would need to greatly rely on discretionary assessments based on qualitative criteria. In Venezuela, the competition authority has chosen not to intervene in most cases, while making clear to the firms concerned that there would be strict enforcement against anticompetitive conduct. 34/ In Mexico, the competition authority undertakes little intervention against concentrated market structures, placing the emphasis instead on control of anticompetitive behaviour; it is neutral with respect to size or the number of enterprises in a particular market. 35/ However, the authority has objected to a proposed merger between two copper wire makers which would have created a company controlling almost 70 per cent of the market and dominating raw materials purchasing. 36/

C. Horizontal RBPs and prices

38. Among the various types of conduct addressed by RBP control laws, none is viewed more widely as being fundamentally incompatible with the viability of competition than horizontal price fixing (including through collusive tendering) and the practices that support it, such as the allocation of markets, customers or sales or production quotas and collective boycotts. Horizontal price fixing or collusive tendering is often illegal per se or in principle, and may attract criminal penalties. Under the new Brazilian competition law, for instance, it is a crime for enterprises to limit or injure free competition or free initiative, regardless of intent; the law specifically prohibits setting conditions of sale with competitors, boycotts among competitors to block market entry, impeding market access of new firms, impeding the access of competitors to materials or technology, and attempts to exclude competitors from access to the mass media. 37/ Similarly, the Kenyan law makes collusive tendering a criminal offence unless it is a joint tender disclosed to, and acceptable to, the persons inviting the tender. 38/ On the other hand, the Russian competition law avoids a per se proscription of horizontal restrictions; it prohibits agreements between enterprises if these lead to a breach of competition, specifically mentioning price-fixing agreements, as well as price collusion at auctions and in organized markets. 39/

39. However, the approach taken to determine the legality of other horizontal RBPs has been less strict. Their legality may be evaluated in the light of efficiency, industrial policy, trade, public interest or "rule of reason" considerations, while particular leniency may be exercised towards cooperation among SMEs. In practice, it has sometimes been difficult to distinguish between cartels and joint ventures aimed at improving efficiency, especially since joint ventures may sometimes involve ancillary restrictions. Thus, cartels may be allowed in some countries for purposes of rationalization of activities, specialization because of crisis conditions or a depression in an industry, if they increase the bargaining power of a large number of weak SME suppliers vis-à-vis dominant monopsonistic buyers or for reasons of public welfare. Export cartels having no effect on the domestic market are also exempted from the application of competition law or are subjected in some countries merely to notification or registration requirements. Research and development joint ventures are usually exempted to some extent; in the EU, joint exploitation of research results is also exempted. The United States has recently provided that production joint ventures should be examined under

a rule of reason standard and should be exempted from treble damages, provided that notification of the venture is made to the competition authorities, the principal production facilities of the venture are located in the United States, and the parties are companies from the United States or from countries that treat United States companies fairly under their competition laws governing joint production ventures. 40/

40. In the Republic of Korea, horizontal "unreasonable concerted activities" are prohibited unless registered with and accepted by the Economic Planning Board, which will consider whether they lead to "a substantial restriction of competition in any particular field of trade against the public interest" 41/ (the law does not apply to enterprises in agriculture, fisheries, or mining). Thus, when six major petroleum refinery companies collaborated in restricting sales by each company, the Fair Trade Commission fined them $3 million. 42/ However, the Commission can permit concerted activities where unavoidable for purposes of industrial rationalization, of overcoming an economic decline in an industry which is restructuring, or of enhancing the competitive strength of SMEs and rationalizing the terms of transaction, subject to safeguards against unreasonable restrictions upon competition. Separate legislation provides for three-year rationalization programmes for declining "sunset industries" and growing "sunrise" industries, which qualify them for government assistance which is conditional upon efficiency improvements; the programmes must include plans for necessary cartel activities and (in the case of sunset industries) mergers, and market entry is restricted. 43/

41. In Germany, the competition law 44/ provides as a general principle that agreements made for a common purpose between competitors shall be of no effect, in so far as their implementation restricts competition and thereby has a perceptible influence on market conditions. However, several types of cartels may be legalized, provided they follow the appropriate procedures, which depend on the type of cartel involved; some cartels merely involve notification to the competition authority ("notification cartels"), others may be objected to after notification ("objection cartels"), while still others may require prior authorization by the authority ("authorization cartels"). Even after being legalized, notification and objection cartels are subject to controls in case of abuse. The rationale for such exemptions, as stated by the drafters of the Act, is that "competition is not in and of itself the goal, but rather the means for improving efficiency and technical progress ... through certain necessary restrictions of competition inherent in rationalization agreements the premise for an increase in efficiency and an improvement in the satisfaction of consumer demands can be set". 45/ Indeed, participants in rationalization agreements must be able to demonstrate that these will enhance technical or economic efficiency and that efficiency gains will be passed on to consumers in the form of lower prices. However, on the basis of an empirical investigation of some legalized rationalization agreements and crisis cartels in Germany, it has been suggested that, while they promote the viability of producers in an industry, there is no compelling evidence that they have greatly increased productivity and efficiency; on the contrary, the evidence suggests that prices are relatively greater, and output relatively less, as a result of cartelization. 46/

42. Rationalization may have some advantage for industries with over-capacity facing long-term structural declines in market demand, particularly where there are high exit costs for single firms. In cyclical, capital-intensive industries, they may impose higher prices on consumers in exchange for a lower degree of risk, lower cost of capital and higher profitability for the firms; yet, by raising profitability, they may also make it possible for firms to tolerate higher short-term costs and the long-run maintenance of excess or inefficient capacity. Other types of cartels, particularly those allowing firms to realize economies of scale or supporting the provision of sector-specific public goods, such as product quality standards, may enhance efficiency, allow market entry barriers or enhance competition by SMEs against larger firms. Yet where the size of such cartels, or their activities, exceed what is optimal for efficiency, or where they facilitate collusion in other areas or the foreclosure of potential competition, cartelization may not generate benefits sufficient to offset the harm to competition. Substantial cost savings and the benefits of risk-sharing and complementarity may also result from joint research and development, which may enhance competition by generating new products; however, if industrial policies rely on supra-competitive pricing by the firms involved to encourage innovation and investment by them, they may also inhibit economic activity in downstream markets.

43. It may not be practicable for competition authorities in developing and other countries to take into account all such factors in assessing the price implications of individual cartels or joint ventures and in deciding whether to authorize them. The distinction between practices that are illegal per se and those subject to a "rule of reason" case-by-case analysis has the merit of providing certainty for economic actors by clearly defining certain behaviour as illegal, as well as economizing on enforcement resources. And, to the extent that a per se prohibition is considered too absolute, it can be mitigated by exemptions for some types of joint ventures or cartels considered likely to have efficiency benefits outweighing anticompetitive effects.

D. Vertical RBPs, dominant positions of market power and prices

44. The competition implications of horizontal and vertical restraints require different kinds of analysis. Among the different types of vertical restraints, the only type which is usually subject to per se prohibitions in most competition laws is resale price maintenance, **and the rationale for a blanket prohibition of even this practice has sometimes been questioned, on the grounds that such a practice may sometimes enhance efficiency**. Other vertical practices would normally be evaluated on a case-by-case basis to determine whether they are harmful, neutral, or even beneficial for competition, taking into account any pro-competitive or efficiency benefits. Some vertical restrictions are seen as efforts to reduce risk and transaction costs, to enter markets, to maintain quality, to promote production efficiency or investment in product development and promotion efforts, or to capture surplus associated with a product. Others are seen as market exclusion or foreclosure devices, or as means of enforcing horizontal cartels by reducing the number of actors or by making it difficult to offer price discounts. But there are differences in competition enforcement policies as to where the line should be drawn between harmful and beneficial

vertical practices. Even where special exemptions are normally provided, as in respect of intellectual property rights, there is some uncertainty as to the circumstances under which the exercise of such rights may be considered to be abusive. However, there is some consensus that the likelihood that vertical restraints will be anti-competitive will depend in large part upon market structure, the market shares of the firms concerned, **the existence of dominant positions of market power, and** the proportion of the market covered by the restraint and entry barriers.

45. Given the concentrated market structures and the limited availability of independent suppliers, customers or distributors that exist in many developing and other countries, their competition authorities have often paid particular attention to vertical restraints imposed by market-dominating firms, as well as pricing abuses by such firms. In some countries, presumptive market share **thresholds for triggering investigations or** for establishing dominance have been laid down. Under the new Brazilian law, a business or group of businesses is prohibited from controlling a substantial part of a relevant market, unless this arises from increased economic efficiency in relation to its competitors; dominance is presumed when a company or a group controls 30 per cent of the market. Under the previous law, cases were brought against 22 pharmaceutical firms for arbitrarily increasing profits by increasing prices by 150 per cent above the rate of inflation over a 30-month period. 47/

46. The Polish Antimonopoly Act **includes as** monopolistic practices constituting abuses of a dominant position countering the formation of conditions indispensable for competition, market division, price discrimination, boycotts, resale price maintenance, predatory pricing imposing onerous contract terms yielding undue benefits and conditional sales; **these** are prohibited unless they are necessary, **for technical, organizational or economic reasons,** to conduct an economic activity and do not induce a substantial limitation of competition. Certain actions by firms in a monopolistic position or dominant position are also prohibited **per se. These are** limitations on production, sales or purchase, particularly where they lead to increases **in sale prices or reductions in purchase prices**, refraining from sale in order to increase prices, and **charging excessively exorbitant** prices. Dominance is defined in a qualitative sense as constituting the position of an economic subject not encountering substantial competition in the market, with a presumption of dominance where there is a market share of over 40 per cent. **Particular attention is placed in this connection on the identification of the relevant market. The concept of "dependent relationship" (partenaire obligatoire), where a customer or supplier cannot avoid trading with the dominant firm if it is to continue its current activities, is also used as an analytical tool in identifying dominance.** Even in the absence of dominance, the law also prohibits agreements to **fix prices**, divide markets, limit the volume of production, **purchases** or sales, limit market access by firms not part of the agreement, **or fix the terms of**

contracts with third parties; it has been suggested that these latter provisions fail to establish a clear distinction between such practices when they are horizontal and when they are vertical, and that a blanket prohibition of vertical practices of this type is not appropriate. 48/ Where a price increase has resulted from any RBP, the Antimonopoly Office may order the price to be lowered, but the Office has been careful about using such powers; recognizing that price control would hinder the transition from a command economy to a market one and given the difficulties of working out costs of production or proving monopoly practices, it has reacted only to the most aggressive price behaviour by monopolists. 49/ **The law also applies to licences of intellectual property rights or know-how, if they have as their effect unjustified restrictions on the freedom of economic activity of the parties and significant restrictions on competition.**

47. In some countries, the competition authorities have attempted to remedy abuses of dominant position by imposing or negotiating prices which may be based on prices or profit levels in similar markets which are competitive, or which are related to an index of costs. Such measures, while temporarily useful for checking abuse (particularly in markets for homogeneous products), would run the risk in the long run of deterring new investment or market entry. The pervasive vertical restraints, exclusionary distribution structures and concentrated markets in many Eastern European countries (and, to a lesser extent, in many developing countries) may, at least during an interim period, require strict enforcement policies in respect of vertical practices and abuses of dominant position. However, care would have to be taken to ensure that the implementation of such provisions does not restore price controls in another form, thereby adversely affecting efficiency. Clear distinctions should be maintained between horizontal and vertical practices, with most of the latter being subject to balanced case-by-case analyses rather than per se prohibitions. Since some vertical restraints such as tying arrangements and exclusive distributorship arrangements may be particularly useful as devices to facilitate market entry, care should be taken not to deter entry into concentrated markets through over-zealous enforcement. In such cases, a misapplication of competition law can induce excessive vertical integration of corporate activities. A clear differentiation should be maintained in the treatment of vertical practices engaged in by dominant and by non-dominant firms (with the former requiring greater scrutiny). But dominance should not be confused with the temporarily high market share arising from successful new entry into a market; qualitative criteria other than market share should be taken into account **in assessing market power**. In general, large firms should not be penalized for market success arising from superior skill or business acumen, and the protection of competition should not be confused with the protection of individual competitors from hard but fair competition. **Given the complexities involved in designing appropriate enforcement policies in this area, it would be useful to have more analysis by UNCTAD of the competition policy treatment of vertical restraints, abuses of dominant position, the exercise of intellectual property rights and the licensing of intellectual property rights and of know-how.**

Chapter III

REGULATION OF NATURAL MONOPOLIES

48. The problems of pricing and vertical RBPs are particularly difficult in the case of natural monopolies. Such monopolies exist where the economies of scale make it very difficult or impossible for market entry to take place and a monopoly by a single supplier is the most efficient solution; typically, such natural monopolies include infrastructure or utility industries based upon carrier networks or grids such as electricity, water, gas, roads, railways, harbours and airports. However, a distinction should be made between **those barriers to entry inherent in the huge sunk costs in natural monopolies, and regulatory entry barriers which may be created by Governments**. A distinction should also be made between those core activities of a natural monopolist where such economies of scale really exist and associated activities over which it has acquired a monopoly **merely** because of regulatory entry barriers; competition in such associated activities is increasingly being allowed to take place in several countries. In some sectors such as transport or energy, competition can arise even in core natural monopoly activities from firms producing partial substitutes, as in the transport or energy sectors. Moreover, technological change **or increased demand** is reducing the ambit of some natural monopolies, notably in the telecommunications industry.

49. **Any liberalization of regulatory barriers to entry in natural monopoly industries, whether in core monopoly or associated activities, might be balanced by the establishment of appropriate safeguards.** While those areas where competition is possible should be subject to RBP controls (particularly to prevent predatory behaviour through cross-subsidization from monopoly areas), ordinary RBP controls by themselves may not suffice to control core monopoly activities and a special system of industry regulation may be required to undertake such tasks. Unlike RBP controls, which seek to reduce private obstacles to the operation of market forces, such industry regulation seeks to emulate market forces by bringing about the pricing and output effects that would occur if the industry were competitive. The establishment of industry regulation, even where desirable in principle, should be subjected to cost-benefit analyses since, as discussed below, regulation of natural monopolies is a complex and resource-intensive exercise.

50. In countries where such regulatory systems have been established, Governments have used different methods for regulating pricing by natural monopolies, in an attempt to balance the objectives of consumer welfare, adequate incentives for producers, efficiency, competition, minimal regulation, stability of regulatory regime and cost-effectiveness. But in no other area are the potential conflicts among these objectives so sharp. Ideally, administered pricing for natural monopolies should attempt to simulate the effects of a competitive market, induce both good service and transparent prices which are related to marginal costs and future investment requirements, impose a degree of risk and accountability on the firm and on its management for their decisions, maintain a degree of flexibility to meet

changing market conditions, provide incentives for cost-cutting by the monopoly and for market entry where possible, and yet **encourage an efficient market structure and** provide enough stability to encourage the firm to make the large investments that are often necessary in such industries. Inevitably, some trade-offs among these objectives have been necessary.

51. In the United States, a common method of controlling pricing by natural monopolies is to regulate the profits or the rate of return on assets they are allowed to earn (known as rate-of-return regulation). This method, while it has the advantage of being relatively simple to administer, may provide little incentive to reduce inefficiencies and improve technology and may also encourage over-capacity or the provision of unnecessary or costly services. There may also be difficulties and a measure of arbitrariness and inconsistency in deciding what should constitute a fair or reasonable return.

52. Regulation by means of "price caps" (also known as "incentive regulation") has now been introduced in the United States in some areas. Similar methods have also been introduced in France to regulate pricing by some natural monopoly PEs. Such "price cap" methods are similar to those used in the United Kingdom where, typically, a ceiling is put on the annual increase over five years (after which the ceiling is reviewed) in the monopoly's prices for individual services or for a basket of services. This ceiling is calculated by subtracting a given number of percentage points from the increase in the Retail Price Index (the RPI-X formula); the X factor may be a higher figure than the rate of inflation, resulting in a price decrease in real terms. The distinctions between price caps and rate of return regulation for natural monopolies are not clear-cut in practice (since the projected rate of return is an important factor in determining the ceiling of the price cap), but the fact that the price ceiling is set for a fixed period provides the firm with flexibility and the incentive of being able to reduce costs without immediately having to cut prices, while allowing the sharing of efficiency gains between producers and consumers after the period is over. However, the successful implementation of price caps depends upon the ability of regulators to obtain accurate information from the regulated company, to assess it, to establish an appropriate ceiling for a few years in advance (taking into account what costs should be) and to stick with this ceiling even if the monopoly makes substantially larger profits than expected. Since price caps may provide an incentive to reduce investment and diminish service, it would also be necessary to regulate the quality of service. **It may also be difficult to apply price-cap regulation uniformly to all operations of enterprises providing both monopolistic and competitive services, because of the risks of cross-subsidization and market foreclosure, as discussed below.**

53. In the United Kingdom, to facilitate the task of establishing the price ceiling, recourse is sometimes made to "yardstick competition", involving the comparison of costs and prices of different regional natural monopolies; in the water industry, special merger controls are also applied to ensure that mergers among regional water authorities do not prevent such comparisons. Similar recourse to "comparative competition" is undertaken in Germany (except

that the markets chosen for comparison are competitive); in undertaking price abuse supervision of a natural monopoly, the Federal Cartel Office takes into account prices in competitive markets that are comparable in terms of products, geographical area or time. For a competition authority which is expected to ensure efficiency of the economy as a whole, such a competition-oriented standard may in theory be more appropriate than an exclusive focus on the revenue position of an individual monopolist. In practice, the German experience indicates that it may often be difficult to find markets that are comparable enough; however, abuse control based on comparative markets has not been found to deter new investment or new entry. 50/

54. In contrast, under both rate of return and price cap systems, regulators have sometimes established prices for some services which are higher than might be justified from the monopoly's own costs (since the monopoly will already have recovered much of its expenditure on capital equipment), or even from replacement costs for capital equipment, in order to provide an incentive for market entry for the supply of these services, or to discourage market exit of existing competitors. As natural monopolies are most common in industries with major distribution networks, to which potential competitors would need to have access, regulators have also had to decide which firms are to be allowed to enter which segments of the market, ensure that interconnection with networks is not denied, control the prices and conditions for interconnection and prevent the monopoly from acquiring too much information about its competitors' businesses while providing access, as well as prevent collusion between the monopoly and the new market entrants. It has also been necessary to ensure that the monopoly is not enabled to cross-subsidize associated activities from monopoly activities while taking into account regulatory obligations upon the monopoly to provide "universal service" to all customers (implemented through cross-subsidization of less profitable basic services for some customers). In general, regulators have had to undertake "asymmetric regulation" between the monopoly's activities and those of its competitors in order to overcome its inherent advantages. In a sense, therefore, regulators in some countries have been driven towards "managed competition" which will, it is expected, become self-sustaining and give rise to dynamic efficiency gains and lower prices in the long term. Taking into account the paradoxes inherent in such an approach as well as considerations of scale and scope economies, avoidance of over-capacity, incentives for investment and security of supply, the provision of universal service, difficulties in regulating natural monopolies have been experienced by some developed countries and there is controversy as to whether and how much competition in some natural monopoly industries is possible and appropriate. 51/

55. The answers to such questions will vary in different industries and countries but it is generally accepted that competition can only be introduced in many natural monopoly industries in many countries in a phased manner. This is not necessarily always the case; in the telecommunications industry in Asia, for instance, it has been suggested that the gap between current supply and potential demand is so large that worry about over-capacity is a distant concern, that radical liberalization alone will attract the large amounts of capital needed for network modernization, and that industry regulation is essential to enable interconnection and prevent abuses. 52/ But the basic

problem in most developing and other countries remains the lack of administrative capacity to make the right decisions regarding the manner and speed of both liberalization and regulation. Given that most developing and other countries have limited purchasing power but massive needs for investment in infrastructure, limited resources and administrative skills, a paucity of data on costs (and difficulties in forecasting costs in an environment of deregulation and high inflation), and a shortage of enterprises capable of competing effectively in non-core monopoly areas, it would certainly not be easy for their authorities in many developing and other countries to undertake such complex tasks. Moreover, natural monopolies in these developing countries may often be operated by transnational corporations (TNCs) which have the possibility of practising transfer pricing abuses, thereby making it even more difficult accurately to identify their costs.

56. In most countries, the provision of natural monopoly services has traditionally been the responsibility of the Government, partly because this may facilitate control of abusive conduct by the monopoly; a natural monopoly in private hands would usually have a greater incentive to charge high prices than would a PE. However, the problem of regulating pricing or anti-competitive behaviour by natural monopolies exists even when these are operated by government departments or PEs, and there may be conflicts **between** the Government's roles as regulator and as owner, necessitating the maximum transparency in regulation. Unlike private firms, PEs may sometimes charge prices which are below costs (restraining market entry). Although commercial pricing (often on a cost-plus basis) by PEs has now gained favour, this may merely mask operational inefficiencies and monopoly situations, 53/ **while PEs may also fail to respond adequately to the incentives to improve efficiency envisaged by price-cap regulation.** Thus, it is important to establish separate institutional bodies to monitor **the** pricing **systems and the operations of** PEs; in France, for example, some natural monopolies are regulated under three-year "contractual plans", setting prices and efficiency and service targets.

57. The need for developing and other countries to mobilize as much private capital as possible for infrastructure investment would suggest that, in respect of non-core monopoly areas, they should avoid granting a monopoly to one particular investor, be it a PE or a single private firm. For this reason, as well as to prevent abuses of market power, it would often be useful to separate contestable sectors from natural monopoly carrier networks or grids; contestable sectors could be exposed to competition by issuing licences providing access to the grid to other suppliers. 54/ This would often coincide with splitting up the monopoly firm in a vertical sense. Thus, for example, the purchase of gas from producers and the sale of gas to users might be made independent from distribution networks, allowing competition in both upstream and downstream markets and reducing the incentive for the distributor to impose anti-competitive access terms. Another useful structural measure might be to break up a large national monopoly into smaller regional monopolies. Both vertical and geographical demonopolization have been implemented in Argentina and the United Kingdom upon privatization of some PEs. Geographical demonopolization would not only have the advantage of allowing "yardstick competition", but would allow competition in the border areas of regional monopolies. In Germany, the Federal Cartel Office has

determined that an exclusive boundary agreement between two gas suppliers preventing each other from delivering gas in the other's delivery region is incompatible with European Union competition law. 55/ While it is true that such structural measures may sometimes be difficult to undertake because of economies of scale or scope, or because investors might be deterred, more investors may in fact be attracted by the smaller size of the investments required. Where firms proposing to enter the market would need interconnection facilities, scale economies may be lost if they are unable to obtain such facilities on appropriate terms. Thus, in Hungary, in order to raise the large capital investment necessary, the PE monopolizing the electricity industry has been broken up into eight generating companies and six regional distributors, most of which will be privatized. 56/

58. For Governments unaccustomed to formal regulation, the practice of "contracting out" public services 57/ would provide a gradual learning process, with the regulatory function embodied in the design and monitoring of the performance indicators specified in the contract. Such indicators could incorporate price or rate-of-return regulation and quality of service, and an element of competition could be introduced by allocating the right to operate the monopoly through a bidding process. 58/ Such "contractual regulation" would have the advantages of giving the investor a more predictable framework than might a general regulation, 59/ of allowing modifications to the contract by mutual accord, and of not requiring the creation of a separate new regulatory agency at the outset. Such a system is implemented in France, for example; municipal services are provided through contractual delegation of municipal functions to private firms. It has **also** been suggested that one solution for countries with a developing market economy is to adopt a dual structure, controlling pricing by natural monopolies in areas where they are already providing service through rate of return regulation or RBP controls of dominant firms, while allowing them freedom to contract with customers for new services on unregulated prices and terms; price caps might be introduced as economies become more mature and cost and productivity trends in the industries concerned become more predictable. 60/ Such methods of "incremental privatization" are increasingly occurring in respect of new services in the global telecommunications industry, for instance, as well as in the electricity generation industry in Asia and in Eastern Europe, 61/ often using "build-own-operate" or "build-operate-transfer" methods. The use of joint public sector/private sector ventures might also be considered, taking into account the inefficiencies sometimes associated with joint ventures (discussed in the Concentration study).

59. However, such methods would still require well-conceived and effectively implemented regulation. While the solutions chosen will depend upon the specific problems faced by each country, **competition authorities should be consulted on the design of the regulatory framework and where appropriate, on the manner and the procedure of contracting out, particularly where long-term concessions are granted**. Technical cooperation from countries having experience in this area would be useful for other countries wishing to regulate competition and/or pricing in different natural monopoly industries in a manner which would be both effective and

workable within the limitations of their resources. International comparisons of prices may be a useful guide so as to allow yardstick or comparative competition in this respect.

60. One relevant factor for developing and other countries in deciding upon appropriate regulatory regimes may be their influence upon foreign trade and investment. In Australia, it has been indicated that one main reason why some firms have been granted licences to compete with Telstra, the former State-owned telecommunications monopoly, is to make the industry used to competition in the home market so it would be better able to compete in the Asian region; conversely, Telstra's decisions as to whether it will proceed in the region by allying with local carriers, by buying stakes in foreign companies, or by competing with them will greatly depend upon the regulatory stance in different countries. 62/ Pricing stability indeed plays a key role in both encouraging foreign investment and in maximizing its benefits - it has been suggested that, when the Argentine telecommunications PE was being privatized, the lack of a credible regulatory regime guaranteeing price stability compelled the grant of an unduly favourable sale price and tariff levels for the PE, in order to compensate investors for the perceived risk. 63/ Where the tariffs of natural monopoly utilities in a country are significantly higher than international prices, this may adversely affect its competitiveness in other economic sectors, and hence its ability to attract investors.

61. Some developing and other countries are beginning to adopt regulatory structures similar to those prevailing in developed countries. In Malaysia, for instance, regulatory bodies covering privatized natural monopoly sectors have been established to protect consumer interests while ensuring the creation of healthy competition. Even while the telecommunications monopoly was still a PE, however, it was suggested that there were problems in respect of the resource costs of regulation (an RPI-X formula is used for price-setting), informational asymmetry between the firm and its regulator and entry-deterrence behaviour against potential competition in respect of "value-added networks". 64/ Malaysia will now license another firm to provide telecommunications services, so as to provide competition and encourage investment. 65/ Similar regulatory frameworks have been introduced in Argentina, Colombia, Chile and Peru. Rate-of-return regulation has been preferred by Jamaica in the telecommunications sector (see the following chapter).

62. In Poland, the Antimonopoly Office has had to deal with numerous cases of abuses of dominant position by natural monopolists, particularly municipal water, electricity, gas and sewerage services, as well as transport services and telecommunications networks. The Office has undertaken steps to **prepare the implementation of** future legal regulations of such sectors by setting up agencies and training staff and has issued communiqués on the approach it takes in some of these sectors. It also has staff on the supervisory level of PE natural monopolies. A new law aiming at breaking the national telecommunications monopoly into small regional companies and encouraging new entrants has been adopted. 66/

63. Thus, there is no easy option for developing and other countries to choose in regulating natural monopolies. A mixture of approaches may be preferable, depending on the market conditions in individual industries and countries, as well as the level of development and administrative capacity and institutions. The need for enough flexibility to allow a learning process to take place should be balanced against the investors' need for a predictable regime. Whichever approach is adopted, however, some general principles might be adhered to. Such principles might include those recommended by the Ad Hoc Working Group on Comparative Experiences with Privatization, i.e.: (a) establishing a clear regulatory framework for each utility with well-defined rules for the State, the service provider and the consumer; (b) establishing the regulatory framework and the regulatory authority before privatizing a public utility; (c) creating market structures allowing for maximum competition where possible; (d) creating competent regulatory authorities and ensuring their independence from political interference; (e) ensuring that the procedures used by the regulatory authorities are transparent and their decisions are made public; and (f) rationalizing the structures for related industries in order to keep the number of regulatory bodies to a minimum, and ensuring that these bodies have a high technical standard. 67/

Chapter IV

COMPETITION, PRIVATIZATION AND DEMONOPOLIZATION

64. As discussed in the previous chapter, the promotion of competition is not always possible in the case of core natural monopoly areas. But in the case of contestable industries (upon which the present chapter will mainly concentrate), the promotion of competition is central to the success of privatization - while ownership matters, competition matters even more for the achievement of efficiency gains. 68/ The time-frame for the promotion of competition may vary. In preparation for privatization, PEs might be exposed to competition ("demonopolized") by liberalizing regulatory entry barriers, by removing subsidies to PEs, by making them subject to RBP controls or by splitting up large PEs to reduce their market power. Alternatively, such measures might be undertaken at the time of privatization, thus avoiding the transformation of public into private monopolies. The conditions for privatization might also be chosen with an eye to maximizing competition. A third possibility is to maintain or even strengthen the monopoly position of the PE, or some measures granting it market power, until after it is privatized, and to remove such measures at a later stage.

65. Some developing and other countries have chosen to demonopolize PEs prior to privatization. In China, for instance, evidence of profit declines in sectors where the monopoly power of PEs was eliminated and non-PEs have entered in large numbers suggests that there has been increased competition in these sectors; profits have not declined in some sectors with continuing monopoly power. 69/ In Mexico, in line with the recommendations of the federal competition commission, it has been announced that, on the expiry of the PE telecommunication's monopoly, users will be able to switch to rival long-distance providers without having to use special access codes, and interconnection between long-distance competitors and local networks will have to be allowed at a rapid pace **to all competent parties at the same rates**. 70/ Mexico has also applied RBP controls against the behaviour of PE monopolies. Under the new Mexican competition law, 71/ although the "strategic activities" of PEs (in sectors reserved by law) do not fall within the jurisdiction of the competition authority, activities of PEs in other areas are subject to RBP control, while government authorities at federal, State and municipal levels must conform to the competition law when they grant concessions to provide public services involving the use of public goods. The competition authority has recently required the PE oil company to grant concessions for petrol stations to all Mexicans on a non-discriminatory basis **and without territorial exclusivity restrictions**. 72/ Similarly, in Chile, cases were brought against the PE telephone monopoly (which has since been privatized) for obstructing interconnection by private firms. 73/

66. Other countries have preferred to demonopolize at the time of privatization. As noted in the preceding chapter, the Russian programme for "Demonopolization of the Economy of the Russian Federation" is pursued in parallel with privatization of PEs. In some countries, RBP control authorities have intervened to ensure that privatization is undertaken in a manner which safeguards competition or prevents abuses. In Germany, for instance, the Federal Cartel Office had intervened on several occasions with

the **former** Treuhandalstalt (the **recently abolished** privatization agency for the Eastern regions), to signal opposition to the sale of a PE to a market-dominating buyer; on one occasion, it had to exercise merger controls to prevent such a sale. 74/ In the former Czechoslovakia, the acquisition by a Franco-Swiss consortium of a majority share in a chocolate manufacturing PE with a monopoly position was permitted by the competition authority on the condition that prices not be raised more than 50 per cent above the cost of supplies over the following five years. 75/ **In Slovakia, the Antimonopoly Office gives its opinion on deconcentration aspects of draft privatization projects; its approach has been based on ensuring that the privatization is accompanied by a restructuring of the enterprise**. 76/ The process of privatization itself has sometimes been implemented in a competitive manner. Thus, in Russia, "small-scale privatization" (of small firms) has been effected mainly through competitive bidding and by auction, as well as through the sale of assets to entrepreneurs already leasing them; small firms account for over two-thirds of enterprises privatized so far. 77/ The Ad Hoc Working Group on Comparative Experiences with Privatization has recommended using competitive bidding to the fullest extent possible in the privatization process, both for non-divestiture and divestiture options. 78/ The success of competitive bidding would of course depend upon whether there is sufficient competition for the contract and whether Governments are able to ensure that the bidding process involves no collusion or exclusionary behaviour - competition authorities could have a valuable role to play in this respect.

67. So far, however, although the promotion of competition has been one of the explicit or implicit objectives of privatization, it has often not been assigned much weight in practice in many developing and other countries; concentrated market structures have often been maintained or even strengthened, particularly where the privatized firms are large and have strong market positions. 79/ It is seldom that specific evaluation procedures or measures have been implemented to verify that public monopolies are not merely being transformed into private monopolies, even in those developing countries having competition laws. Competition authorities are often not provided with the mandate to screen the privatization process, or even to consult with the privatization authorities. This may be because it has been assumed that the combination of privatization and the reduction of regulatory entry barriers, as well as the general process of economic reform, would suffice to ensure that competitive market forces develop. There may also be a reluctance to break up large PEs being privatized because it might make their sale more difficult or decrease their sale price, their willingness to invest or their efficiency, or their purchasers' willingness to further invest in them. One key problem of privatization in poorer developing countries and Eastern European countries is the mismatch between the large numbers of PEs to be sold off and the shortage of entrepreneurs (including foreign firms) which are interested in acquiring a PE, have the requisite financial resources for acquisition and further investment, and are capable of operating it efficiently. 80/ In any event, given the concentrated nature of the economies of developing and other countries and the shortage of **capital**, the only available and capable acquirers might already be holding dominant market positions, which would have given them the opportunity to build up the necessary capital. Such problems may be made worse if privatization is implemented in an over-hasty manner, without taking into

account the structural constraints and absorptive capacity of the economy (especially in the difficult economic circumstances of stabilization and structural adjustment programmes). In the first wave of privatizations which occurred in Chile in the 1970s, for example, credit constraints and the rapidity and scale of privatizations resulted in sales of PEs to oligopolies with access to the international capital markets (because of their assumed credit-worthiness); this led to increased market concentration. 81/ In the Republic of Korea, banks being privatized were acquired by large conglomerates, which used the banks' resources to buy up other firms being privatized, as well as to take over other firms. 82/

68. Economies of scale and sunk costs of PEs, shortages of managerial resources, or the attitudes of buyers, do sometimes place limits on the degree of deconcentration and demonopolization that can be implemented at acceptable financial or efficiency losses. In Hungary, for instance, a group of farmers expressed the intention to contest the sale of a PE producer of oilseeds to an Italian firm, on the grounds that the privatization provided the firm with monopsony and monopoly powers. However, the director of the competition authority noted that, given the small size of the Hungarian market, it made no economic sense to break up the firm before privatization. 83/ In Poland, it is reported that attempts to break up large firms to be privatized have discouraged investors interested in acquiring large market shares. 84/ Demonopolization may be particularly difficult in formerly centrally planned economy countries, since some monopolies may be single factories, or since vertical integration may be important for ensuring continuity of supplies. In any event, it may be less important to break up firms producing traded goods in the traded sector which are subject to international competitive pressure. But as discussed in the preceding chapters, breaking up PEs being privatized may sometimes yield substantial gains for both competition and efficiency, as well as helping to attract more investors.

69. Competition problems may be made worse by the fact that acquirers have often obtained reduced prices, incentives, subsidies or regulatory protection (including through debt-equity swaps) from Governments as a condition for the purchase of a PE. In Mexico, for instance, when a telecommunications firm (in which core equity stakes were sold to United States and French telecommunications firms, as well as to a local group) was privatized, it was granted a six-year monopoly, in return for large investments. 85/ In Jamaica, when the PE telecommunication monopoly was sold to a British firm, the monopoly was granted an exclusive 25-year licence for both domestic and international services (renewable for 25 years) and the right to charge rates sufficient to give it post-tax earnings of at least 17.5 per cent. 86/ **(However, an investigation is now being undertaken of the monopoly for abuse of dominant position.)** In the automobile and telecommunications sectors in some Eastern European countries, foreign investors which have taken over PEs being privatized have pressed (sometimes successfully) for higher tariffs, import quotas, or public procurement exclusivity. 87/ While such arrangements may be unavoidable in some circumstances, they should be screened by a competition authority to try and keep dangers for competition to a minimum. Thus, in the former Czechoslovakia, an agreement between the Government and a joint venture composed of the national telecommunications authority and two United States telecommunications firms, granting the venture a 20-year monopoly on cellular telephone services and a 10-year non-exclusive licence on data services,

was approved by the competition authority because of the large investments necessary; however, the authority refused to approve the grant of exclusive marketing rights for these services to the venture because of the danger to future competition. 88/ The question of subsidies or protection to foreign investors is further dealt with in the following chapter.

70. Post-privatization RBP controls may help to make up for the initial failure to demonopolize prior to or during privatization. In principle, RBP controls upon privatized firms should be the same as those upon any other firm. But special attention may be needed from competition authorities if a privatized firm retains dominant market power because of, for example, large size, established product names, financial strength (enabling predatory behaviour), vertical integration, exclusionary vertical arrangements, subsidies or regulatory protection. Post-privatization controls would obviously be easier to implement if appropriate pre-emptive measures were undertaken at a time when the Government was still the owner of the firm concerned; this would apply in particular to structural measures to split up the firm, which competition authorities are normally reluctant to impose upon firms in the private sector. In general, the earlier the stage at which demonopolization measures are undertaken, the better. Compared to demonopolization after privatization, demonopolization measures undertaken at the time of privatization would usually be a better alternative. However, the radical changes involved for the firm in combining privatization and demonopolization may sometimes destabilize it and place it at a competitive disadvantage in the market-place. Moreover, pressures from potential acquirers of a PE may make demonopolization difficult to implement at the time of privatization.

71. By contrast, demonopolization prior to privatization (particularly if it is undertaken in a phased manner and is combined with reforms to increase efficiency) would allow a PE some opportunity to prepare to withstand the full force of competition as a firm in the private sector. The Government would thus be able to encourage more effective long-term competition in the market, without being subjected to immediate pressures from the need to satisfy potential acquirers and to maximize the sale price of the PE. Demonopolization prior to privatization would also allow competition authorities a better chance to familiarize themselves with the competition situation in the relevant sector, and this knowledge might be used to make recommendations regarding how to privatize the PE in a competition-enhancing manner. In Poland, for instance, market analyses and studies on the prospects for particular industrial sectors are carried out to help choose the method and strategy for privatization and implement foreign investment policy. 89/ On the other hand, even if a PE is exposed to competition, it may be difficult for Governments to act in an even-handed manner between the PE and private firms; there is a conflict between the State's roles as regulator and as owner. This would increase the need for impartiality and independence on the part of the competition authority, which should be respected within the government administration. The need to "demonopolize" PEs prior to privatization is all the greater because the privatization process has often proved difficult and slow in developing and other countries, particularly for large PEs. However, it may not always be feasible to undertake prior demonopolization if it would be inefficient, or if the Government is under pressure to privatize as quickly as possible.

Chapter V

COMPETITION POLICY AND TRADE AND FOREIGN INVESTMENT LIBERALIZATION

A. Effects of foreign direct investment upon competition

72. Extensive liberalization of foreign investment regimes has taken place in developing and other countries in recent years. Liberalization has often been combined with reforms of fiscal, financial and other incentives. Such measures (as well as liberalization of other regulatory barriers and privatization) have contributed to the increased flows of foreign direct investment (FDI) received by some of these countries, although many countries which have liberalized have failed to obtain any significant increases in investment inflows. In most developing countries, FDI constitutes a small fraction of overall investment, but FDI is much more important in a few relatively skill-intensive sectors such as electronics, automobiles, pharmaceuticals or petroleum (as well as in some primary sectors in some countries), 90/ **and in some service sectors.**

73. In assessing the market position of TNCs, it should also be taken into account that part of FDI is directed towards production for export markets and would not affect competition within domestic markets for final products. On the other hand, it should be noted that the sources of FDI are highly concentrated (particularly in value terms) and that there are extensive networks of strategic alliances among TNCs. Around 1 per cent of TNCs own about half of the FDI stock emanating from their home countries, and the largest 100 TNCs account for about a third of worldwide FDI stock. 91/ Moreover, most developing and other countries attract smaller numbers of TNCs and less FDI than developed countries. The share of SMEs in FDI is small in value terms but larger in terms of numbers of affiliates; among United States-based firms, for instance, only 4 per cent of the assets of all foreign affiliates was controlled by SMEs in 1990, but 28 per cent of TNC parent companies were SMEs and they controlled 7 per cent of foreign affiliates. 92/ But SMEs from developed countries prefer to invest in other developed countries. However, the relative importance of FDI by SMEs from developed countries continues to grow steadily. FDI by firms from some developing and other countries has also increased substantially in recent years; **moreover, the FDI share from developing countries is higher in host developing countries (19 per cent in 1990) than in host developed countries.** 93/ The beneficial effects of competition from developed country SMEs would be mitigated by their tendency to produce a restricted range of products and to target narrow market segments, allowing them to exercise a relatively high level of market power in such segments. Thus, 32 per cent of the developing country affiliates of small TNCs belong to oligopolistic industries and, while 72 per cent of small TNCs compete with large firms, over half of small TNCs in some industries do not compete with large TNCs. 94/ However, developed country SMEs (as well as investors from developing and other countries) may also be competing among themselves, as well as with local firms. The growing diversity in size, country origin and sectoral specialization of foreign investors should increase the range of their market behaviour (as well as that of their competitors and customers), which would benefit competition. Competition would also be increased by

continuing reductions in barriers to foreign investment, which should favour market entry by foreign investors other than large TNCs disproportionately (since large TNCs are usually better placed to overcome entry barriers).

74. In those sectors where there is a significant stock of FDI directed towards production for domestic markets, it would have usually extensive effects upon competition, since the average size of foreign affiliates of TNCs in developing countries is larger than that of their indigenous competitors. 95/ TNC affiliates are also often wealthier, more efficient or more profitable. They tend to operate in relatively globalized industries requiring extensive technology, capital **or** marketing skills. Even where national firms have a similar size or degree of diversification as TNC affiliates, or have acquired comparable skills, these affiliates would still often be more competitive by virtue of the fact that they are part of a large international entity; worldwide operations of TNCs tend to be more vertically integrated than those of purely national firms and TNCs often conclude exclusive dealing arrangements with their suppliers and/or consumers. 96/ However, local firms in developing countries may sometimes be as (or even more) efficient as TNC affiliates, in part because of greater local knowledge, management autonomy and freedom as to sources of technology and production inputs.

75. There is frequently a positive correlation between the foreign-owned share of developing country industries and indices of market concentration. 97/ This could partly be because TNCs have a role in increasing concentration (there is evidence of this in a few cases). It could also be partly because TNCs are attracted to markets where entry barriers or economies of scale allow them to earn above-average returns (TNCs tend to operate within oligopolistic structures in their home economies as well). 98/ And it could be partly because of TNCs' possession of scarce managerial, technological, financial and organizational endowments. There is evidence that TNCs tend to concentrate in sectors most subject to economies of plant or firm size and economies of scope, as well as in knowledge-intensive industries. 99/ But concentration is not invariably associated with the presence of TNCs, particularly where their main competitors are other TNC affiliates: a study of the pharmaceutical industry in Brazil found no such association even though the industry was almost completely dominated by foreign-owned firms. 100/

76. The initial market entry by foreign investors has often reduced industrial concentration and increased competition, leading to lower prices by incumbent firms (which may comprise both local firms and other foreign-owned firms). This would be the case particularly if the investor's competitors respond to the presence of the new market entrant by improving their own efficiency. The higher the barriers to market entry and the more entrenched the incumbents, the greater may be the potential usefulness of foreign investors as an "instrument of competition", owing to their ability to surmount such barriers. Particularly in markets in which TNCs are dominant, entry of a newcomer TNC with similar competitive advantages may be the most effective means of stimulating competition. This increased competition may continue, or it may be adversely affected by market exit by some incumbent firms, specialization or collusion among firms in the sector, or market dominance by the investor.

77. Much will depend upon the mode of entry by the investor and upon industry- and country-specific circumstances. Where entry is through greenfield investment and the subsidiary is not introducing a new product into the economy, the concentration ratio should fall and competition increase, at least in the short term. Where the investment takes place through the take-over of a local firm, or a joint venture with it, there may be no immediate effect on the concentration ratio; indeed, take-overs or joint ventures may strengthen concentration where the TNC (through imports) and the local firm had been competing (or would have competed) in the same sector, or where the firm taken over would otherwise have been a strong competitor to the foreign investor. But take-overs may be followed by increased competition because of the emergence of a stronger competitor.

78. If the market presented ex ante competitive characteristics, entry by a TNC with better access to specialized and scarce resources could lower the degree of rivalry. Foreign investors would be more likely to drive out local competitors if the latter are inefficient or if the market is small. In Kenya, for instance, the entry of foreign firms weakened the competitive position of domestic market incumbents. 101/ But even if higher concentration leads to decreased competition (which is not necessarily the case), the net effect might still be welfare-improving if efficiency gains outweighed the loss from monopolistic behaviour, particularly if the resources which are freed are employed more effectively elsewhere (which did not happen in Kenya). Moreover, as discussed in the Concentration study, the impact of market entry by a foreign investor is often circumscribed by the emergence of a dual market structure, with an oligopoly of TNCs focusing upon higher value-added market segments and local firms catering for less profitable segments requiring less skills.

79. However, having entered into new markets, foreign investors may create their own barriers to potential competition or drive competitors out from the market through the use of RBPs rather than through greater efficiency. In the Latin American electrical equipment industry, for example, there is evidence of cross-subsidization, control of supply channels, formal and informal collusion, interlocking directorates, predatory pricing and anticompetitive mergers among and by TNCs. 102/ The structure of a TNC **may** allow it to pursue distinctive patterns of behaviour, **such as** discriminatory pricing, **including by means of** transfer pricing abuses, 103/ or cross-border subsidization of predatory pricing or non-price competition. Surveys of TNCs based in several developed countries in the late 1970s found that transfer pricing manipulation was an extremely common practice and that an important motive was to charge below full costs so as to penetrate into markets or otherwise gain a competitive advantage; recent studies have found that larger TNCs are less likely to engage in transfer pricing manipulations than smaller ones and that United States-based firms were now more likely to practise market pricing than had earlier been the case. 104/ Examples of transfer pricing abuses through over-invoicing include the famous librium-valium cases, involving the over-invoicing by a Swiss pharmaceutical company of its subsidiaries in several countries. 105/

B. Competition policy and foreign investors

80. For the purpose of controlling RBPs by foreign investors, no special provisions are needed in competition laws (other than in relation to extraterritorial information-gathering and enforcement, which is dealt with below). The application of competition laws to the behaviour of foreign investors should be in conformity with the national treatment principle laid down by the RBPs set (para. E.3). There is in fact no evidence that foreign investors practise RBPs any more often than domestic firms. However, since they would often be able to acquire strong market power and since **TNCs' greater efficiency, size or** global orientation would **often** enable **them** to engage in practices different from those used by independent firms **to acquire dominant positions**, competition authorities **would need to make efforts to prevent them from abusing their dominance**. But it would be necessary to take into account that TNCs may regard some practices (such as tied purchases) as a legitimate part of their global competitive strategies and might therefore react to the possibility of investigation by reducing or restricting their investments. Moreover, in examining whether acts or behaviour between TNC parents and affiliates, not having restrictive effects outside the related enterprises, are abusive or not, it would also be necessary, as provided for by the Set, to consider whether these are appropriate in the light of the relationship between the enterprises concerned. In practice, it may be difficult to assess the appropriate scope of exemptions in this respect, given the increasing diversity of non-traditional forms of investment used by TNCs, and a case-by-case analysis would be necessary. In Spain, a United Kingdom chemicals firm is being investigated in respect of price increases for products it sells to a joint venture it has established with a Spanish firm, allegedly aimed at depressing the profits of the venture. 106/

81. However, foreign investors would usually have no objection to being subject to competition rules if these are broadly in line with universal competition principles and are applied in a speedy and flexible manner which fully takes into account efficiency considerations. They may also welcome the application of competition rules against RBPs by their competitors. RBP controls should check anticompetitive behaviour by incumbent firms in reaction to market entry by the foreign investor, although it may be necessary to exercise leniency in respect of mergers or joint ventures between incumbents (or with the foreign investor) where these may make them more efficient. Even for TNCs operating in oligopolistic markets, a major source of uncertainty remains from their being exposed to competition (including predatory competition) from their rivals within the oligopoly. Controls upon abuses by some firms with global market power may in fact encourage specialization by other large firms, leading to greater economic efficiency; one reason why some American electronics firms have chosen to manufacture a considerable part of their production inputs within their own transnational networks, rather than to rely upon independent suppliers, has been the fear that predatory rivals might withhold from them the most advanced versions of those components while incorporating them in their own products. 107/ The adoption of competition laws in a growing number of countries and a degree of convergence in national competition regimes would also promote security and stability for

TNCs (as well as reducing risks of countries attempting to attract foreign investors through the non-adoption or weak or uneven application of competition policies).

82. But to the extent that concentration arises because foreign investors have been attracted to industries with entry barriers, efforts to lower such barriers may be the best means to promote market entry by both domestic and foreign firms, thus maximizing the welfare gains from the presence of the foreign investors. And to the extent that firms are sometimes enabled to practise RBPs by entry barriers created by Governments, it would be more efficient to modify government policies to remove the incentive or the possibility to engage in such RBPs. In Germany, for instance, an above-average number of price abuse proceedings has involved firms operating in heavily regulated markets such as pharmaceuticals or energy supply. 108/ The fact that RBP controls are available as a safeguard may alleviate concerns as to possible abusive behaviour by foreign investors and should thus assist competition authorities when they advocate liberalization of foreign investment regimes. Towards this end, competition authorities might undertake market analyses as inputs for the decision as to whether, when and upon what terms liberalization should take place in a given sector.

83. In implementing the reform process in developing and other countries, it would be preferable to liberalize import trade before, or at the same time as, liberalizing foreign investment controls, so that foreign investment is not attracted to protected sectors. However, as noted in the previous chapter, potential foreign investors have sometimes pressed for special protection (including exemptions from competition law) as a precondition for investing. In Kenya, for instance, some TNCs have demanded virtually exclusive rights before investing, while proceedings against firms suspected of engaging in RBPs have been hampered by threats of relocation. 109/ In Egypt, it is reported that foreign firms demanded protection against allegedly dumped imports from Japan as a price for staying in the country. 110/ Such demands should be resisted as far as possible since they may make foreign investment a liability rather than an asset for competition. But where unavoidable, protection should be limited, temporary and conditional upon increases in efficiency.

84. Foreign investors are also often granted investment incentives or subsidies; these may be difficult to avoid in the current climate of competition among Governments for foreign investment. However, some flexibility may be necessary in the application of competition policy in this area, particularly as subsidies or incentive systems, if they effectively attract new economic agents, may make markets denser and more competitive, at least in the short term. Over time, however, entry-inducing rents are frequently appropriated by the new incumbents, partly because incentives are often denied to other potential investors out of concerns about excess capacity, destabilization of markets and misallocation of resources. **In China, for example, the entry of foreign investors has stimulated competition in several key industries, but domestic firms have been disadvantaged because of tax incentives and other preferential treatment given to foreign investors.** 111/ Governments need to take fully into account the repercussions for competition

in granting (or refusing) incentives, subsidies or special protection, as well as obligations entered into under the Uruguay Round Agreements. For this purpose, prior consultations among the competent national governmental authorities concerned (including the competition authority) would be preferable to ex post facto intervention by the competition authority against agreements concluded by another government body. When a German car firm undertook a joint venture with a PE having a dominant position in the car market of the former Czechoslovakia, the venture was promised, in return for heavy investments by the German firm, the maintenance of tariffs against car imports for some years, non-tariff barriers, various subsidies and privileges and exemption from some provisions of the competition law; a controversy subsequently arose when the competition authority protested against the alleged failure to apply to it for approval of the venture, as well as against a sharp price rise and shortages of cars. 112/

C. Effects of trade upon competition

85. Competition from imports is a key element in ensuring that a national market remains competitive. Tariffs, quantitative restraints (QRs), production subsidies to national producers and countervailing and anti-dumping duties against imports or the grant of exclusive importation rights all reduce current competition and future market entry by foreign producers and contribute to the exercise of market power by locally-based producers (which may include foreign-owned firms) to the detriment of local consumers. In particular, QRs, if used in a generalized and permanent manner, may cause greater harm to competition than the equivalent tariff restraint by preventing foreign suppliers from expanding output in an import market in response to collusive pricing by domestic producers, or by encouraging collusion between foreign suppliers and local firms. The contribution of imports to competition in the markets of developing and other countries would be particularly important, given their concentrated nature. On the other hand, premature or over-hasty exposure of local firms of such countries to competition from low-tariff imports may decimate infant industries and lead to concentration of market power in foreign exporters or in trading intermediaries. But the efficiency and competitiveness of local producers would be undermined if the "infant industry" protection they are granted is too intensive or over-lengthy, shielding them from the discipline of international competition and encouraging misallocation of resources to sectors which are uncompetitive.

86. However, even where trade barriers have been liberalized, as in many developing and other countries, imports may have limitations as a source of competition even in the tradable goods sector. This may be the case, for example where: imported products are focused on only some market segments, or do not directly compete with locally-made products; competition among foreign suppliers is weak, enabling high prices or RBPs; there is collusive or exclusionary behaviour among domestic producers or between domestic and foreign producers or trading companies; intellectual property rights restrict parallel imports or competing technologies; there are private or regulatory barriers to access to distribution channels; or there are shortages of foreign exchange. In Chile, for instance, extensive, indiscriminate and sudden import liberalization in the 1970s did succeed to some extent in putting a ceiling on domestic prices and in increasing the efficiency of those firms which survived. 113/ However, in many cases, price decreases were not

substantial, because competition among foreign suppliers was based on product differentiation rather than on price and because many of those local firms which did not go bankrupt either merged or, because they controlled distribution channels, began to import "competing" products. National production became exposed to wide fluctuations in international prices for some products and to dumping. More pragmatic policies adopted in the 1980s proved more fruitful.

D. Competition policy and import trade

87. Vigorous enforcement of competition policies is particularly important in countries where barriers to imports are high. Conversely, the reduction of regulatory entry barriers to imports in a given sector would tend to reduce the need for intervention by competition authorities in such a sector; in Germany, for instance, it is mainly due to strong import pressure, especially in industrial markets, that supervision of price abuses plays only a minor role in competition law enforcement (such abuses are also difficult to prove in practice). 114/ But even though competition policies and liberal trade policies share the common objective of removal of barriers to the competitive process, an open trading regime should be seen as complementary to competition policy, rather than as a substitute. A reduction of trade barriers cannot overcome other entry barriers, or ensure that local and foreign firms will in fact behave in a competitive manner, which would be the task of competition policy. In analysing market power, therefore, it is important that competition authorities neither underestimate nor overestimate the contribution of imports to competition. Difficulties may arise in particular as to how to take into account potential market entry by imports; there are differences in the competition enforcement policies of developed countries on this point (see the Concentration study), and developing and other countries would need more information regarding the implications of different approaches. Competition authorities should also take measures against RBPs which reduce the beneficial effects of trade liberalization. Specific sectors or areas to which Governments might need to pay particular attention include trading intermediaries, transportation, distribution and some agricultural commodity and high-technology products, given the often high concentration in such areas and their key importance (as discussed in the Concentration study). In recent cases, for example, the Commission of the European Communities took action against 15 European shipping firms for operating cartels and market-sharing arrangements on routes between France and some West and Central African countries, as well as against 11 "shipowners' committees" and 4 liner conferences for abuse of dominant positions to eliminate competitors on the shipping trade between Northern Europe and Zaire. 115/

88. Special difficulties may be experienced where competition regimes overlap with regimes for the protection of intellectual property and/or technology regimes, given the need to balance competition and free trade against protection of proprietary rights. In Kenya, for instance, a distributor was prevented from importing a branded pharmaceutical due to territorial restrictions imposed by a United Kingdom patentee on a United States licensee from whom the distributor had bought the product. 116/ In recent years, there were tying clauses in 5 per cent of technology import contracts by Nigerian firms (prior to intervention by the authorities) 117/ and in 8 per cent of purchasing contracts for machinery and raw materials by

Thai firms. 118/ Other clauses in 1,546 import contracts dealt with by the competition authority of the Republic of Korea between 1981 and 1989 (the majority comprising technology licences) included restrictions on raw materials and parts, restrictions on marketing channels and methods, sales quantities and prices, restrictions on handling competing products or technologies and restrictions on utilizing transferred technologies after the expiration of the contract. 119/ As developing and other countries strengthen protection of intellectual property rights, in the light of the Uruguay Round Agreements provisions on trade-related aspects of intellectual property rights, they would also need clearer national rules to prevent the exercise of these rights from becoming the basis for abuse of market power. But efficiency considerations and the risk of deterring foreign suppliers would need to be taken into account. Problems which may arise in this area are not merely bilateral in nature (i.e. between one importing country or firm and one exporting country or firm), but could also concern other firms or countries. A recent antitrust case in the United States arose over restrictions upon sub-licensing imposed by a United Kingdom glass manufacturing company in its licensing agreements for float glass technology, which would have kept the licensee American companies from designing and building glassmaking plants overseas; the company has agreed with the Justice Department to end the restrictions, but other private suits are still pending. 120/

89. Difficulties may also arise where trade regimes attempt to deal with allegedly unfair practices by foreign exporters, such as "dumping" (discriminatory pricing combined with predatory pricing) or subsidized prices, if they cause injury to domestic producers. Most competition laws would not proscribe aggressive pricing practices unless there exists a substantial risk that alleged predators could strengthen market power, affecting competition rather than individual competitors, and the competitive role of pricing as a means of entering a new market would be taken into account. Some developing and other countries are starting to apply trade rules relating to anti-dumping and countervailing of subsidies, following the trading regimes prevailing in developed countries. There appears to be scope for using competition concepts and philosophies for mitigating the protectionist bias of trading regimes in this area. But such solutions would obviously be easier to apply if appropriate changes were made on a multilateral basis. 121/ Voluntary export restraints imposed by trading partners would also often induce the formation of export cartels which may have "spill-over" effects upon the domestic market. 122/

90. Developing and other countries applying their competition laws to RBPs affecting their import trade will sometimes experience the need to have recourse to extraterritorial exercises of jurisdiction to obtain information or to enforce decisions, **including in cases of international cartels and other RBPs having effects in more than one country**. Whatever the theoretical scope of the jurisdiction claimed, however, it would usually be difficult in practice for competition authorities in developing and other countries to enforce such jurisdiction. A country victimized by offshore price fixing, bid-rigging or predatory pricing, for instance, may be unable (even if it manages to acquire information about these RBPs) to obtain

redress against the firms concerned; **it** may not even be **possible to seize** the relevant goods, which may be in the hands of innocent purchasers when they reach the affected country. Where an overseas merger might have anti-competitive effects on the domestic market, a competition authority would usually be able to intervene effectively only if the firms concerned had local subsidiaries; even if this were the case, its actions would be unlikely to have much impact if the main production facilities of the firms were located overseas. While such difficulties may be faced by all countries, they would particularly affect developing and other countries, since they have limited resource capabilities and foreign firms trading with these countries are less likely to have a substantial establishment therein. Given the complexities involved in this area and the controversies that have arisen among developed countries (as well as the efforts to reduce such controversies through cooperation agreements), developing and other countries would need information as to the implications of different legal approaches to extraterritorial claims of jurisdiction and resolution of jurisdictional conflicts, procedural mechanisms for information-gathering and enforcement overseas, and the possibilities for strengthen**ing international information exchange,** cooperation and consultations. This would enable them to implement effectively their competition laws as their economies become increasingly integrated into global markets, while minimizing conflicts with the laws or interests of other countries.

91. But national action by developing and other countries in this area is unlikely to prove enough by itself, and stronger consultations and cooperation among countries would also be desirable. A study by the OECD secretariat has recommended the abolition of the exemptions currently granted in competition laws for export cartels, subject to an efficiency defence where the cartel can demonstrate that it serves to overcome a genuine barrier to competition in the importing country. 123/ It may be recalled in this connection that the RBPs Set of Principles and Rules (para. E.4) provides that States should seek appropriate remedial or preventive measures against RBPs within their competence when it comes to their attention that such RBPs adversely affect international trade, particularly the trade and development of developing countries.

92. In exercising their advocacy functions in this area, competition authorities might identify sectors for which trade liberalization would be appropriate to improve competition (the powers of the Sri Lankan authority in this respect have been described in chapter 2), where trade liberalization has not had sufficient impact and needs to be supplemented by trade promotion measures, or where internal regulations (such as in the areas of distribution or product standards) are reducing competition from imports. They might also argue, where appropriate, against increased trade protection; such a function is performed by competition authorities in some countries, although sometimes with limited success. In Poland, for example, the Antimonopoly Office demanded a comprehensive evaluation of the consequences of abandoning liberal trade policy and urged that there should be an explanation of the specific reasons for the adoption of protectionist measures and that the scope of such protection should be limited and its duration and the annual rate of its reduction should be specified in advance. 124/ However, because of the asymmetry of response by trading partners to its earlier extensive trade

liberalization, Poland introduced a new and higher tariff structure in August 1991, including higher tariffs for products which the Office had identified with non-competitive domestic markets. 125/ Increased protection has invariably led to price increases where there was market dominance. 126/

93. In practice, therefore, for competition authorities to increase their effectiveness in advocating reduced protectionism, it would be essential to both induce confidence in their ability to take action against any anti-competitive practices by foreign exporters (as discussed above) and to have a supportive international environment where a liberal and pro-competitive trade regime is also maintained by trading partners. The conclusion of the Uruguay Round Agreements marks an important step towards ensuring that such a pro-competitive regime prevails at the international level. The Agreements have important provisions bearing upon competition policy. 127/ It may now be appropriate to take stock of these provisions and to see whether and how they might be further developed.

E. International cooperation

94. In general, the trend towards trade and foreign investment liberalization in developing and other countries, as well as the globalization of international markets and increased international competition in many sectors, should make the task of competition authorities easier. Such trends are forcing large TNCs to compete among themselves with fewer restraints and should also lead to stronger competition between them and other firms (as well as among these other firms). Nevertheless, **increased market openness may enhance the incentive for firms to resort to RBPs to maintain their market positions, thus "privatizing" the restraints hitherto applied by Governments. Moreover,** there may be adverse effects for competition where these same trends reinforce the market power of an oligopoly of large firms in some product or geographical markets. Particular problems may be experienced as a result of market concentration at the global level and the transnational strategic alliances which exist in some sectors (such as aerospace, telecommunications digital switches, microprocessor or electronic components industries) where barriers to entry are high and technological change is rapid and costly, 128/ enabling the creation of "technological cartels". 129/ (As discussed in the Concentration study, other potential problem sectors include some agricultural commodities, some services and some industries producing homogeneous products.) Such concentration or alliances may be necessary to undertake the huge investments required in such sectors and may not necessarily lead to decreased competition in the long term, particularly since the alliances may often be temporary and technologies may change rapidly. But, as discussed in the Concentration study, competition among oligopolists in such sectors would not necessarily extend to all product or geographical markets, nor may it involve competition based on prices. There is therefore a risk of abuses, particularly in the markets of some small economies which may not attract some of the firms in the global oligopoly.

95. As discussed above, it would be difficult for individual competition authorities, particularly those of developing and other countries, to ensure that such firms are accountable for any abuses of market power. National competition policies generally balance the costs and benefits of potentially anti-competitive conduct only at the national level and can protect and promote competition within countries. However, in response to the globalization of economic activity, there is also a need to strengthen efforts to protect the vitality of competition at the global level, so as to safeguard global economic efficiency and consumer welfare and to provide opportunities for access to international markets by firms from all countries, particularly developing and other countries, to the benefit of all countries and in a manner which would support the economic reform efforts of developing and other countries. Even if all countries were to implement active and effective competition policies in accordance with national considerations, they would not necessarily be able to address conduct or market structure harming competition and efficiency at the global level. Increased international production implies that competitive conditions in one market increasingly determine the activities of a TNC in other countries, as the operations of all affiliates are potentially affected. Moreover, with increased specialization in international trade, each country more often finds itself in the position of a consumer. Thus, in Germany, the Federal Cartel Office has objected to the takeover by a German firm producing automotive steering and transmission systems of the transmission division of a United States firm, taking into account that the takeover would have worsened international competition due to the two companies' dominant position in world markets, and this would have spilt over onto German markets. 130/ The United States Justice Department has also challenged the proposed takeover, taking into account not only adverse effects upon United States markets, but a substantial lessening of competition in worldwide technological innovation in automatic transmissions for certain types of vehicles. 131/

96. But less stringent competition enforcement in some countries may impede market access by foreign firms or encourage the perception that an unfair advantage in international competition is being provided to firms from these countries. Competition policy may also discriminate against firms based in other countries. There may be occasions when there are extraterritorial and/or concurrent exercises of jurisdiction by competition authorities or when the application of the competition policy of one country clashes with efficiency considerations or with the industrial policy in another country, leading to conflicting legal requirements upon firms. Moreover, national RBP control laws cannot by themselves address the disparity between the competition principles upon which they are based and the anticompetitive consequences which may sometimes follow from the application of trade policies - nor are trade regimes likely, in the absence of an international framework, to draw unilaterally upon competition concepts and philosophies **(particularly the focus on consumer welfare and economic efficiency)** to mitigate protectionist behaviour.

97. Thus, there are strong common interests among countries in strengthening multilateral consultations and cooperation in the area of competition policy in a manner which would address its implications for global welfare and trade, take account of each country's individual concerns, and minimize tensions

arising from recourse to unilateral action. The Set of Principles and Rules constitutes a key step towards the progressive elaboration of such a multilateral framework. The Set, although it sets out some broad competition principles, is mainly concerned with detailed rules relating to control of RBPs. The universal adoption of market-oriented economic policies, implying the acceptance of competition as the guiding principle for economic activity, the steady trend towards convergence in national competition policies and enforcement doctrines, as well as the conclusion of the Uruguay Round Agreements, all suggest that further multilateral efforts may now be appropriate in the area of competition policy. As a prelude to such efforts, action might be undertaken to identify or to strengthen "common ground" in the approaches followed on different competition questions by Governments, including in-depth analyses of differences in the scope of competition laws in individual sectors, and of the effectiveness of enforcement of competition laws, including enforcement in cases of RBPs having effects in more than one country.

98. In the light of the considerations discussed in this report, any fresh initiatives undertaken in this area by UNCTAD might focus upon three lines of action: (a) how to improve the delivery of, and results obtained from, technical cooperation in this area; (b) identifying "common ground" in the approaches followed on different competition questions by Governments; (c) shedding light and encouraging exchanges of views in areas where the "identification of common ground" is more difficult, such as the role of competition policy in the strengthening and improvement of the economies of developing and other countries and, in particular, the development of the business community; taking into account economic globalization and liberalization of the economies of developing and other countries, the identification and adoption of appropriate measures to help those countries that might be hampered by RBPs; the interface between competition, technological innovation and efficiency; the competition policy treatment of vertical restraints and abuses of dominant position; the competition policy treatment of the exercise of intellectual property rights and of licences of intellectual property rights and know-how; differences in the scope of competition laws in individual sectors, in the light of the process of economic globalization and liberalization; and the effectiveness of enforcement of competition laws, including enforcement in cases of RBPs having effects in more than one country. In the light of such work, consultations might be held within the Intergovernmental Group of Experts on: how the Set of Principles and Rules might be better implemented; the competition policy implications at the national, regional and international levels of globalization and

liberalization; techniques and procedures for detecting and sanctioning collusive tendering, including international cartels and other anti-competitive practices; and strengthening and encouraging recourse to **information exchange,** consultations and cooperation mechanisms in the area of competition policy, **at the** bilateral, regional and multilateral **levels.** This would be in line with the Cartagena Commitment. 132/ It would also **constitute progress towards fulfilling** the mandate recently provided by the Trade and Development Board for UNCTAD to prepare policy analysis and to provide a forum for intergovernmental deliberations and global consensus-building on the new and emerging issues on the international trade agenda, including trade and competition policy issues. 133/

Notes

1/ "The Role of Competition Policy in Economic Reforms in Developing and Other Countries" (TD/B/RBP/96/1).

2/ See report of the Intergovernmental Group of Experts on Restrictive Business Practices on its eleventh session (TD/B/39(2)/7), annexes I and III.

3/ **See "The Role of Competition Policy in Economic Reforms in Developing and Other Countries" (TD/B/RBP/96/Rev.1).**

4/ **See "Report of the Intergovernmental Experts on Restrictive Business Practices on its thirteenth session" (TD/B/41(2)/2), annex I.** Written comments were received from the Governments of Poland, United Kingdom and United States of America.

5/ In the Trade and Development Board Decision of 29 April 1994 on Developments and Issues in the Uruguay Round of Particular Concern to Developing Countries (see Report of the Trade and Development Board on the Second Part of its fortieth session (TD/B/40(2)/24 (vol. I)), it is stated in para. 11 that "The Board agreed that UNCTAD should ... (d) prepare policy analysis and provide a forum for intergovernmental deliberation and global consensus-building on the new and emerging issues of the international trade agenda, such as trade and environment and competition policy, thus contributing to a better understanding of such issues, including their development implications for developing countries."

6/ **See "Agreed conclusions of the Intergovernmental Group of Experts" (TD/B/RBP/L.68/Rev.1).**

7/ See "Final Report of the Ad Hoc Working Group on Comparative Experiences with Privatization to the Trade and Development Board" (TD/B/40(2)/21).

8/ Including Argentina, Brazil, Chile, Colombia, Côte d'Ivoire, **Cyprus,** Fiji, Gabon, Kenya, India, Jamaica, **Mali, Malta,** Mexico, Pakistan, Peru, Republic of Korea, **Romania,** Sri Lanka, Thailand, Tunisia, Venezuela **and Zambia**.

9/ Including Bulgaria, the Czech Republic, **Georgia,** Hungary, Lithuania, Poland, **Slovakia** and the Russian Federation. See R. Pittman, "Some critical provisions in the antimonopoly laws of Central and Eastern Europe", 26 International Lawyer 485 (1992).

10/ See C. Gray and A. Davis, "Competition policy in developing countries pursuing structural adjustment", The Antitrust Bulletin, vol. XXXVIII, No. 2, Summer 1993.

11/ **See "Economic competition and restrictive business practices and the development of the Jamaican competition legislation" (UNCTAD/ITD/10), consultant report prepared for the UNCTAD secretariat by Mr. Cezley I. Sampson.**

12/ See also Gray and Davis, op. cit.

13/ Ibid.

14/ See "FTC Chairman finds progress in global antitrust enforcement", Antitrust & Trade Regulation Report, 28 October 1993, p. 568.

15/ See "Corporate Policies in the Republic of Korea" (UNCTAD/ITP/65).

16/ See "Monopoly regulation and fair trade in Korea", Fair Trade Commission, Republic of Korea, 1991.

17/ See the statement of the delegation of the Republic of Korea in TD/B/39(2)/7, p. 13.

18/ **See "Competition and trade in the post-Uruguay Round" (UNCTAD/ITD/11), consultant report prepared for the UNCTAD secretariat by Mr. Kyu Uck Lee.**

19/ See B. Pinto, M. Belka, and S. Krajewski, "Transforming State enterprises in Poland: microeconomic evidence on adjustment", Policy Research Working Paper 1101, World Bank, March 1993.

20/ See Antimonopoly Office, Competition Law and Policy in Poland (1990-1993), Warsaw, January 1994.

21/ Ibid. See also "Hungary, Poland balancing competition, need to protect firms during transition", Antitrust and Trade Regulation Report, vol. 63, p. 63, 9 July 1992.

22/ **See "Bulletin Number 1", Antimonopoly Office of Poland, Warsaw, 1994.**

23/ **See statement of Polish delegation in the "Draft Report of the Intergovernmental Expert Group on Restrictive Business Practices, on its Fourteenth Session" (TD/B/RBP/L.67).**

24/ See Frischtak, C., "From monopoly to rivalry: policies to realize the competitive potential of transnational corporations", in Transnational Corporations, vol. 1, No. 2, August 1992, p. 57.

25/ See "India - An industrializing economy in transition", World Bank, 1989.

26/ Communication received from the Government of the Russian Federation.

27/ See UNCTAD, "Trade and Development Report, 1993" (UNCTAD/TDR/12), Part Two, and "International monetary and financial issues for the 1990s", vol. II, UNCTAD/GID/G24/2, p. 73.

28/ See Competition law and policy in Poland ..., op. cit.

29/ See "New antitrust legislation is signed by President of Brazil", Antitrust and Trade Regulation Report, 30 June 1994.

30/ See section 6, Fair Trading Commission Act, No. 1 of 1987, as amended.

31/ Information provided by the Government of Sri Lanka.

32/ Communication received from the Government of the Russian Federation.

33/ See A.J. Jatar, "Implementing competition policy on recently liberalized economies: the case of Venezuela" (mimeo), Caracas, October 1993.

34/ Ibid.

35/ See "Mexico's anti-trust law put to test", Financial Times, 5 July 1994.

36/ Ibid.

37/ See "New antitrust legislation is signed by President of Brazil", Antitrust and Trade Regulation Report, 30 June 1994.

38/ The Restrictive Trade Practices, Monopolies and Price Control Act, 1988.

39/ See the law of 22 March 1991 on competition and restrictions of monopolistic activity in commodity markets.

40/ See National Cooperative Production Act of 1993 (HR 1313), adopted on 10 June 1993.

41/ See articles 11 and 12 of the Monopoly Regulation and Fair Trade Act.

42/ See "Monopoly Regulation and Fair Trade in Korea", Fair Trade Commission, 1991.

43/ See "Corporate policies in the Republic of Korea", op. cit.

44/ The Act Against Restraints of Competition of 27 July 1957.

45/ See Audretsch, D., "Legalized cartels in West Germany", International Institute of Management, Berlin, 1988, p. 3.

46/ Ibid.

47/ See "Brazilian Government opens probe of drug firms for antitrust violations", Antitrust and Trade Regulation Report, vol. 64, p. 591, 13 May 1993.

48/ See Pitmann, op. cit.

49/ See J. Ordover and R. Pittman, "Competition policies for natural monopolies in a developing market economy", Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper EAG 92-9, 9 November 1992 (mimeo).

50/ Communication received from the German Government.

51/ See for example International Energy Agency, "Electricity supply in the OECD", 1992, pp. 46-47.

52/ See P. Smith and G. Staple, "Telecommunications sector reform in Asia - towards a new pragmatism", World Bank Discussion Paper No. 232.

53/ See Trade and Development Report 1992 (UNCTAD/TDR/12), Part Three.

54/ See the Conclusions and Recommendations of the Ad Hoc Working Group on Comparative Experiences with Privatization, annex I, contained in TD/B/40(2)/21.

55/ See "FCO finds gas distribution plan to infringe EU competition rules", Antitrust and Trade Regulation Report, vol. 66, 28 April 1994.

56/ See "Hungary paves way for power sell-off", Financial Times, 7 April 1994.

57/ The forms of privatization for infrastructure may include inter alia the granting of an operation or maintenance contract, sale of development rights through build-operate-transfer schemes, and sale of ownership and development rights through build-own-operate schemes. See the Conclusions and Recommendations of the Ad Hoc Group on Comparative Experiences with Privatization, op. cit.

58/ Ibid.

59/ Ibid.

60/ See Ordover and Pittman, op. cit.

61/ See "World electricity", Financial Times, 14 December 1992.

62/ See "Investors move as Asia gets on the phone", Financial Times, 2 June 1993.

63/ See A. Hill and M. Abdala, "Regulation, institutions and commitment - privatization and regulation in the Argentine telecommunications sector", World Bank, Policy Research Working Paper 1216.

64/ See C. Adam, W. Cavendish and P. Mistry, "Adjusting privatization", James Currey, London, pp. 268-269.

65/ See "Malaysia will curb telecoms monopoly", International Herald Tribune, 18 May 1994.

66/ See "Eastern Europe on the line", The Economist, 8 February 1992.

67/ See Conclusions and Recommendations of the Ad Hoc Working Group on Comparative Experiences with Privatization, op. cit.

68/ See the Conclusions and Recommendations of the Ad Hoc Working Group on Comparative Experiences with Privatization, op. cit.

69/ See World Economic Survey, United Nations publication (E/1993/60), pp. 197-198.

70/ See "Playing Monopoly", The Economist, 9 July 1994.

71/ Ley Federal de Competencia Economica. Entry into force on 1 June 1993.

72/ See "Playing Monopoly", op. cit.

73/ See "Handbook on restrictive business practices legislation" (TD/B/RBP/49).

74/ Communication received from the German Government.

75/ See "Philip Morris deal to test CSFR competition office", Business Eastern Europe, 25 May 1992.

76/ **See The Antimonopoly Office of the Slovak Republic, Annual Report 1994.**

77/ Communication received from the Government of the Russian Federation.

78/ See Conclusions and Recommendations of the Ad Hoc Working Group, op. cit. Divestiture refers to the privatization of capital. Non-divestiture options include corporatization, the privatization of management (management contracts, leasing and concessions), joint ventures between public and private enterprises, and the contracting out of public services.

79/ See O. Bouin and Ch.-A. Michalet, "Rebalancing the public and private sectors: developing experience", OECD, Paris, 1991.

80/ See report of the Ad Hoc Working Group on Comparative Experiences with Privatization on its first session (TD/B/39(2)/8).

81/ See V. Bhaskar, "Privatization in developing countries: theoretical issues and the experience of Bangladesh", UNCTAD Review, No. 4, 1993 (UNCTAD/SGO/7), p. 83. Such problems were avoided during the second wave of privatizations which took place in the 1980s.

82/ See paper by Linsu Kim, "The evolution of public policies and private sector responses in science and technology in Korea" (mimeo).

83/ See "Sale of Hungarian firm to foreign buyer will be challenged on competition grounds", Antitrust and Trade Regulation Report, 11 March 1993, vol. 64, p. 274.

84/ See "Investors see a new star rising slowly in the east", Financial Times, 5 January 1993.

85/ See World Investment Report, 1992. "Transnational corporations as engines of growth", (United Nations Sales publication No. E.92.II.A.19) p. 89.

86/ See "Adjusting privatization", op. cit., pp. 142-147.

87/ See "Free trade and foreign investment in Central Europe", East West (Fortnightly Bulletin), 15 July 1991, and "West hides behind Polish tariffs", Financial Times, 10 March 1992.

88/ See "CSFR: Eurotel wins a little, loses a little", Business Eastern Europe, 27 July 1992.

89/ See "Privatization in Poland", Information Centre, Ministry of Privatization, October 1992.

90/ See United Nations, World Investment Report 1993 (ST/CTC/156), Annex Table 3; J. Dunning, "Multinational enterprises and the global economy", Addison-Wesley, Wokingham, United Kingdom, 1993, pp. 422-434, and consultant study prepared for the UNCTAD secretariat by E.D. Ramstetter, Foreign direct investment and exports of manufactures from developing economies: Part II: an empirical evaluation by regions and countries (UNCTAD/ITD/2).

91/ See United Nations, World Investment Report 1993, pp. 22-23, op. cit.

92/ Ibid., p. 25.

93/ **See "Trends in foreign direct investment" (TD/B/ITNC/2), report by the UNCTAD secretariat.**

94/ See United Nations, "Small- and medium-sized transnational corporations - role, impact and policy conclusions" (ST/CTC/160, pp. 77-79).

95/ See J. Dunning, op. cit., pp. 422-434 and World Investment Report, op. cit., pp. 122-124.

96/ Ibid.

97/ See "Multinational enterprises and the global economy", op. cit., pp. 429-431 and World Investment Report, op. cit.

98/ Ibid. See also World Investment Report 1992 - Transnational Corporations as Engines of Growth (STC/CTC/130), United Nations, New York, 1992, p. 123.

99/ Ibid.

100/ See R. Jenkins, Transnational corporations and industrial transformation in Latin America, Macmillan, London, 1984.

101/ See World Investment Report, op. cit., p. 124.

102/ See "Multinational enterprises and the global economy", op. cit.

103/ The Set of Principles and Rules (para. D.4. (b)) lists as a RBP, if it constitutes an abuse or an acquisition and abuse of a dominant position of market power, "discriminatory (i.e. unjustifiably differentiated) pricing or terms or conditions in the supply or purchase of goods or services, including by means of the use of pricing policies in transactions between affiliated enterprises which overcharge or undercharge for goods or services purchased or supplied as compared with prices for similar or comparable transactions outside the affiliated enterprises".

104/ See Dunning, op. cit., pp. 518-519.

105/ See C. Greenhill and E. Herzbolheimer, "Control of transfer prices in international transactions - the RBPs approach", in MNCs beyond the market - intra-firm trade and the control of transfer pricing", Ed. R. Murray, Harvester, Brighton, 1981.

106/ See "ICI faces anti-trust inquiry", Financial Times, 19 November 1992.

107/ See Vernon R., "Transnational corporations: Where are they coming from, where are they headed?", Transnational Corporations, vol. 1, No. 2 (August 1992), p. 7.

108/ Communication from the German authorities.

109/ See report of the Intergovernmental Group of Experts on Restrictive Business Practices on its tenth session (TD/B/1310).

110/ See J.M. Stoyford et al., "Rival States, rival firms - competition for world market shares", Cambridge University Press, Cambridge, 1991, p. 219.

111/ **See "World Investment Report 1994 - Transnational corporations, employment and the workplace" (UNCTAD/DTCI/10), p. 108.**

112/ See OECD, "Methods of privatizing large enterprises", Paris, 1993 and "Czech, Slovak, federal officials examine impact of Skoda/VW venture", Antitrust and Trade Regulation Report, 19 March 1992, p. 364.

113/ See Trade liberalization in Chile: experiences and prospects, (United Nations Sales publication No. E.91.II.D.18) 1992.

114/ Communication received from the German Government.

115/ See "ECU 15 million in fines are imposed on shipping firms", Antitrust and Trade Regulation Report, 2 April 1992, p. 422, and "EC Commission fines shipping conference for practices breaching articles 85 and 86", ibid., 14 January 1993, vol. 64, p. 31.

116/ Beecham Group vs. International Products Ltd., quoted in D. Gladwell, "The exhaustion of intellectual property rights" (1986), 12 European Intellectual Property Review, p. 368.

117/ See "The relevance of recent developments in the area of technology to the negotiations on the draft international code of conduct on the transfer of technology" (TD/CODE TOT/55).

118/ See "Multinational enterprises and the global economy", op. cit., p. 439.

119/ See "Corporate policies in the Republic of Korea", op. cit.

120/ See "Pilkington bows to US pressure on process licensing", Financial Times, 27 May 1994.

121/ See "Competition and Trade" (UNCTAD/ITD/9).

122/ See the Concentration study and OECD, Obstacles to trade and competition, 1993.

123/ See Obstacles to trade and competition, op. cit.

124/ See "Annual Report on Activity of the Antimonopoly Office 1992".

125/ See "OECD economic surveys - Poland", OECD, Paris, 1992.

126/ See Competition Law and Policy in Poland, op. cit.

127/ See Trade and Development Report 1994, United Nations publication (Sales No. E.94.II.D.26).

128/ See the Concentration study.

129/ See Brainard R., "Internationalizing R & D", OECD Observer, February/March 1992.

130/ See "German agency objects to acquisition of U.S. affiliate in transmission sector", Antitrust and Trade Regulation Report, 22 April 1993.

131/ See "Justice Department challenges automatic transmission merger plan", Antitrust and Trade Regulation Report, 25 November 1993.

132/ Paragraph 147 of the Cartagena Commitment states that "efforts should be made by national governments or regional authorities to develop cooperation between national competition groupings, including competent authorities of regional groupings".

133/ See TD/B/40(2)/24 (vol. I) op. cit.